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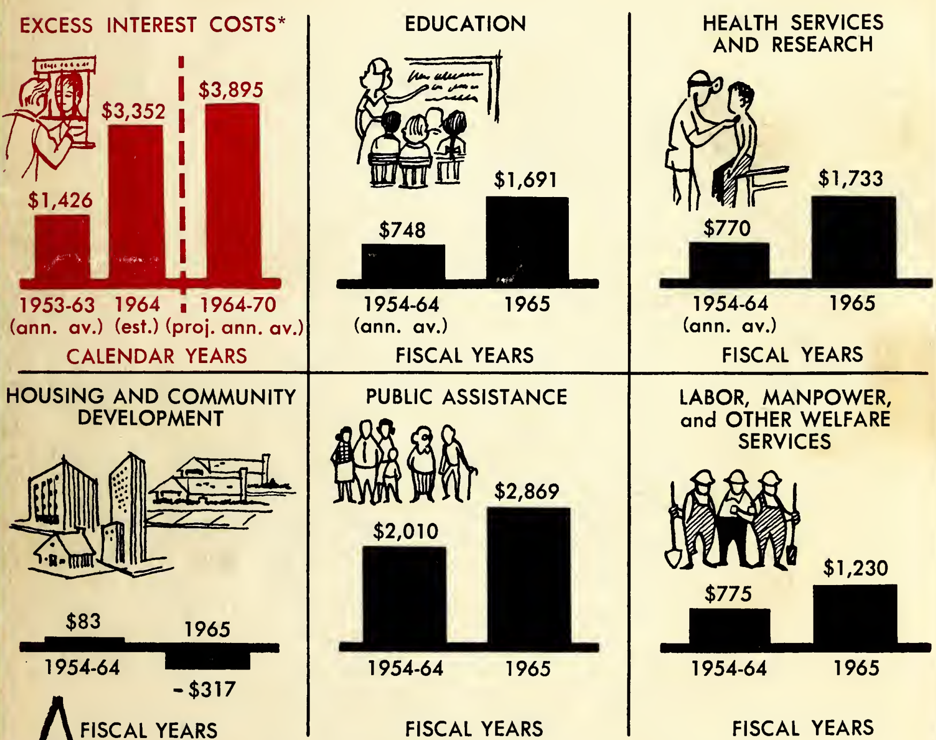
THE TOLL OF RISING INTEREST RATES

THE ONE GREAT WASTE IN THE FEDERAL BUDGET

EXCESS INTEREST COSTS IN THE FEDERAL BUDGET CONTRASTED WITH BUDGET OUTLAYS FOR PROGRAMS RELATED TO WAR AGAINST POVERTY

(Millions of Dollars)



*Interest payments in excess of what they would have been if 1952 ... had been maintained.

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THE TOLL OF RISING INTEREST RATES

The One Great Waste
In The Federal Budget

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I. Summary And Theme: "Where's The Money Coming From?"

Our unmet nationwide needs

Despite an economy yielding more than 600 billion dollars in goods and services a year, and a Federal Budget of 98 billion, every proposal to deal more vigorously with the unmet needs of our people and our nation is met by the question: "Where's the money coming from?"

About 34 million Americans still live in poverty. With due allowance for private and State and local action, a war to the finish against poverty would entail additional Federal Budget outlays of at least 5 billion dollars a year for this specific purpose. But the Federal Budget for fiscal 1965 contains only half a billion dollars net for the new anti-poverty package.

We have hardly commenced to catch up with our unmet needs in education, health services and research, housing and urban renewal, mass transportation, and resource development. Yet, the fiscal 1965 Federal Budget represents a downward trend in outlays for all domestic purposes, when measured validly against population and national production.

The root causes of rising racial tensions will not be removed until the States and localities spend much more to combat bad housing, bad schools, and high unemployment. But again, where is the money coming from? Comparing 1963 with 1952, while the Federal debt rose only somewhat more than 16 percent, State and local debts rose about 200 percent.

In their private lives, the 66 million Americans who live in poverty or deprivation (above stark poverty, but below a minimum adequacy standard) wonder where the money is coming from to increase their incomes, lift the handicaps fastened upon their children, and brighten their hopes.

Huge waste in the face of huge wants is intolerable

If we use our productive resources more fully and expedite our rate of economic growth, this will generate more money for all purposes. But never can we afford to waste recklessly and remorselessly billions of dollars in money and wealth already available to us, nor to distribute inequitably the money which already courses through the arteries of our economic life.

The prime example of waste and inequity in public affairs is tight

money and rising interest rates, the policy of the "independent" Federal Reserve System which commenced in earnest around 1952 and still persists. Whether we are spending inefficiently or too much for national defense or the farm program—or some other programs—is a matter of judgment or degree; for none can question that we now need vast national defense, and programs to stabilize farm prices and protect farm income. But the Federal Reserve policy has imposed scores of billions of dollars of rising interest costs upon private and public borrowers for no useful purposes, thus rendering them less able to serve essential purposes. The policy has been fraught also with injustice, transferring these scores of billions in rising interest payments to those who should do without this unconscionable income supplementation.

This monetary extravaganza has not abated. From mid-1963 to mid-1964, the rate of expansion of the money supply was drastically tightened. Correspondingly, during the first five months of 1964, compared with the first five months of 1963, the rates of interest on new borrowings by the Federal Government rose 6.1 percent for long-term bonds; 16.5 percent for 3-5 year issues; 22.1 percent for 9-12 month issues; and 20.8 percent for 3 month bills. And this leads to higher interest payments by all.

Magnitudes of the interest-payment extravaganza

For the eleven-year period 1953-1963 inclusive, the rising interest rates in themselves imposed an excess interest cost of 15.7 billion dollars upon the Federal Budget, 2.3 billion upon States and localities, and 32.1 billion upon all private borrowers, for a grand total of 50.1 billion. Estimated for 1964 alone, the excess interest costs will be more than 3⅓ billion upon the Federal Budget (about 40 percent of the Federal deficit for fiscal 1964), and more than 10 billion upon all public and private borrowers.

If the prevalent monetary policy continues, the excess interest costs, during the seven years 1964-1970 inclusive, are estimated as: 27.3 billion dollars upon the Federal Budget, 6.6 billion upon States and localities, 54.8 billion upon private borrowers, for a grand total of 88.7 billion—an average of 12.7 billion a year, and 15.4 billion in 1970 alone.

Why not help the poor instead?

The excess interest charges against the Federal Budget, as estimated for calendar 1964 alone, are enough to increase by 46 percent the total outlays proposed in the fiscal 1965 Budget for education, health services and research, housing and community development, public assistance, and

labor, manpower, and other welfare services—these being programs most relevant to the war against poverty. The excess interest costs in the Budget, as estimated for the calendar years 1964-1970, would be enough to increase the total proposed fiscal 1965 outlays for all of these programs by 54 percent—for all fiscal years from 1965 through 1971.

Viewing next the nationwide costs of rising interest rates upon all public and private borrowers during the period 1953-1963, alternative private and public economic policies, if they had turned this amount of income flow in a more wholesome direction, could in each year have lifted the average annual incomes of all American families living in poverty (below $3,000 a year) from $1,778 to $2,295, or more than two-fifths of the way out of the poverty cellar. And the estimated nationwide excess interest payments, for the period 1964-1970, involve an amount sufficient to lift above the poverty level in each year *all* families in the United States now living in poverty.

It is not suggested that the amounts involved in these excess interest payments should have been, or henceforth should be, redirected exclusively to the war against poverty. But we have gone far astray, when we combine the monumental waste of rising interest payments with the plea that the money is not available to do what we can least afford to neglect.

The larger damage wrought by the prevalent monetary policy

The average annual expansion of the money supply by only 1.8 percent during the past eleven years has been probably less than half the rate of expansion required to float an adequate U. S. economic performance. In addition, the serious aggravation of income maldistribution by rising interest rates has contributed even more powerfully to our economic troubles, caused primarily by oversaving and overinvestment in the means of production, relative to expansion of private consumption and public demand for goods and services. Thus, the prevalent monetary policy bears large responsibility for the poor economic performance which has caused us to forfeit, since early 1953, about 530 billion dollars of total national production (measured in 1963 dollars) through first quarter 1964, and about 32 million man-years of employment opportunity through second quarter 1964. And we risk forfeiting almost 700 billion dollars of national production and about 40 million man-years of employment opportunity, during 1964-1970 inclusive, if the prevalent monetary policy (and some other national economic policies) persist.

As for the inflation at times since 1953, some prices and incomes have risen too fast, while other prices and incomes were rising too slowly or

actually falling, and these distortions have hurt the whole economy. In this connection, the redistribution of income and the allocation of credit through the prevalent monetary policy have served only to feed the fat and starve the lean. Our balance of payments and gold difficulties have stemmed primarily from the poor performance of the American economy during the past eleven years, compared with excellent performance by some competitor economies in the free world. The prevalent monetary policy, by damaging us at home, has worsened our gold and balance of payments problem.

Proposed new policies

(1) Congress should require that the Federal Reserve assure an annual rate of expansion in the money supply roughly in accord with the goal for economic growth set forth annually in the President's *Economic Report.* This would keep interest rates within bounds;

(2) Congress should concentrate authority to regulate the money supply in the Federal Reserve Board, appointed by the President and confirmed by the Senate, instead of having this function shared with five additional members of the Federal Open Market Committee, drawn from private banks. Vital public functions should be publically exercised;

(3) Congress should require that each *Economic Report of the President* deal in full with monetary problems and policies, to achieve integration of monetary policy with other basic national economic policies;

(4) Toward further strengthening the President's hand, the fourteen-year terms of the members of the Federal Reserve Board should be reduced to four years; and the term of the Chairman should be made coextensive with that of the President, who should also have clear legislative authority to designate a new Chairman at any time from among Board members;

(5) Because aggregate enlargement or contraction of the money supply tends to strengthen the strong and weaken the weak, both legislative and Presidential action should move the Federal Reserve toward more selective monetary controls;

(6) Even prior to the needed legislation, the President and the Congress, as well as private economic leadership, should enlarge the understanding and interest of the American people, with respect to monetary policies which so greatly affect their opportunities and progress.

This study has been directed by Leon H. Keyserling, with the assistance of Philip M. Ritz and Antoinette Chautemps. Appreciation is due Lawrence A. Leonard for earlier spade work when on the staff of the Conference.

II. The Direct Toll Of Rising Interest Rates Upon Public Budgets

Wasteful Federal spending is never justifiable

The Federal Budget, containing both a spending program and a tax program, is the prime instrument of national economic policy. Thus, this study of the toll of rising interest rates starts with a look at the effect upon the Federal Budget.

Some believe that the spending side of the Federal Budget should be much higher, in order to make more progress against poverty and unemployment, to promote higher economic growth, and to reduce grave deficiencies in domestic public services. Others believe, for a variety of reasons, that Federal spending should be greatly reduced. But on one point these two sides can agree completely. The Federal Budget is no place for billions of dollars of wasteful spending—spending which yields no benefits measuring up to the costs, or which is positively damaging to the national economy and the public well-being. Indeed, the ruthless elimination of wasteful spending leaves more room in the Federal Budget for productive and efficient spending. President Johnson himself is an outstanding exponent of this position.

Similarly, some believe that a large Federal budgetary deficit—meaning a large excess of expenditures over tax receipts—should deliberately be undertaken or accepted when, as now, we have high levels of idle manpower and plant. Others believe that every step should be taken, even now, to eliminate the deficit by balancing the Federal Budget as rapidly as possible. But here again, both sides can agree that the deficit should not be enlarged by extravagant or even positively harmful spending. And in view of the strongly-held view that we should try to balance the Federal Budget, a deficit caused in large part by wasteful spending makes it just that much harder to get popular approval for enough spending for services the nation and the people need.

The direct toll of rising interest rates upon the Federal Budget

Comparing 1963 with 1952, as shown by the first chart following this chapter on page 8, the interest rates paid by the Federal Government on

new borrowings rose 49.3 percent in the case of long-term bonds; 74.6 percent for 3-5 year issues; 81.2 percent for 9-12 month issues; and 82.3 percent for 3 month bills. These trends were not due to "inflation"; consumer prices rose only 15.4 percent over the same period of time.

As shown by the chart on page 9, again comparing 1963 with 1952, the average interest rate on the total outstanding interest-bearing Federal public debt rose 45.2 percent. This rise was less than the rises on new borrowings alone, because a large part of this total debt was incurred at lower interest rates. Nonetheless, the 45.2 percent rise explains the huge rise in the interest toll upon the Federal Budget, even though the debt itself rose only in the neighborhood of 16 percent over the same span of years.

As the same chart indicates, the Federal Budget paid out 15.7 billion dollars *more* in interest during the eleven-year period 1953-1963 inclusive than it would have paid out if 1952 levels of interest rates had been maintained, granted the increased size of the debt itself. In 1963 alone, these excess interest payments amounted to 3.15 billion dollars, or about 38 percent of the total Federal deficit of 8.3 billion dollars for the fiscal year 1964 ending on June 30, 1964.*

The above data are based upon average interest rates during 1963 as a whole. But the trend toward higher interest charges against the Federal Budget continued with a vengeance as that year progressed, and on into 1964.

Comparing the average for the first five months of 1964 (latest available data as of this writing) with the average for the first five months of 1963, the interest rates on new borrowings were up 6.1 percent in the case of long-term bonds; 16.5 percent for 3-5 year issues; 22.1 percent for 9-12 month issues; and 20.8 percent for 3 month bills.

The direct toll upon State and local budgets

Rising interest rates paid by the Federal Government cause rising interest rates throughout the nation. This is because there tends to be a natural or conventional spread among interest rates, depending upon the nature of the security and the identity of the borrower. And the same tight money policy which causes the interest rates on Federal borrowings to rise causes the interest rates on practically all other public and private borrowings to rise also.

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* As announced by the President on July 18, 1964.

As shown by the chart on page 10, comaring 1963 with 1952, the average interest rate on new borrowings by State and local governments rose 47.7 percent. Meanwhile, the average interest rate on the total outstanding interest-bearing debt of State and local governments rose 23 percent. Due to this, during the eleven years 1953-1963 inclusive, State and local governments paid out 2.3 billion dollars *more* in interest than they would have paid out if 1952 levels of interest rates had been maintained. In 1963 alone, the excess interest payments by State and local governments were more than half a billion dollars.

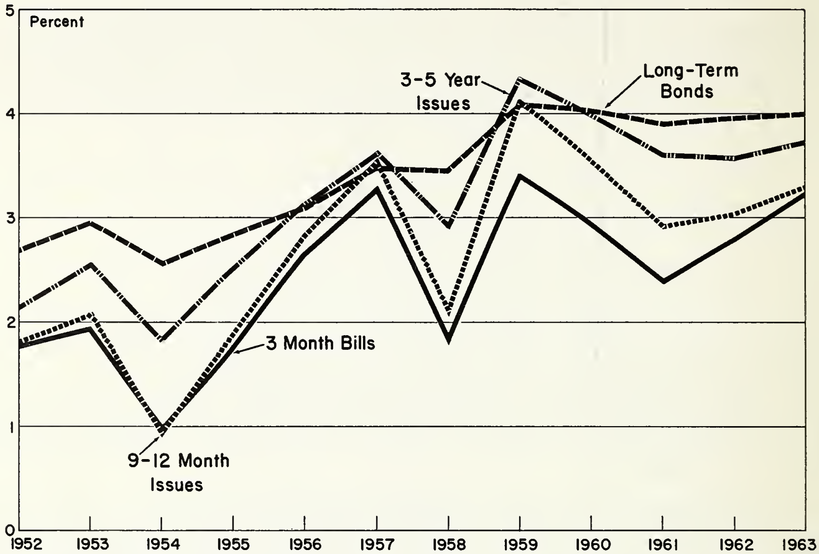
The toll of rising interest rates has been a much heavier burden, relatively speaking, upon State and local budgets than upon the Federal Budget. This is because of the efforts of the States and localities to meet an excessively rising *share* of our total nationwide domestic public needs, despite sources of tax revenues much inferior to those of the Federal Government. The total interest-bearing State and local debt outstanding rose about 200 percent or approximately tripled from 1952 to 1963, while (as already indicated) the interest-bearing Federal public debt rose only somewhat more than 16 percent. From 1962 to 1963, the State and local debt rose 9.4 percent.

All this calls for the following comment: It is on its face unreasonable that the Federal Government should be looking to and calling upon the States and localities to continue to bear this excessively increasing *share* of our nationwide domestic public responsibilities, even while a national instrumentality—the Federal Reserve System—is impressing these tremendously rising interest costs upon the States and localities.

The following three charts amplify this chapter.

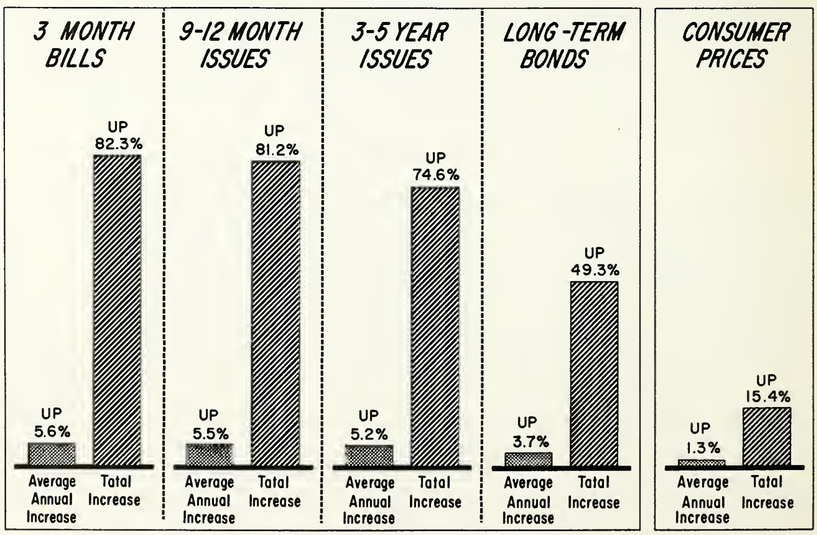
INTEREST RATES ON NEW BORROWINGS BY U.S. TREASURY, 1952–1963

Calendar Years



PERCENTAGE RISE IN INTEREST RATES ON TREASURY BORROWINGS, 1952–1963

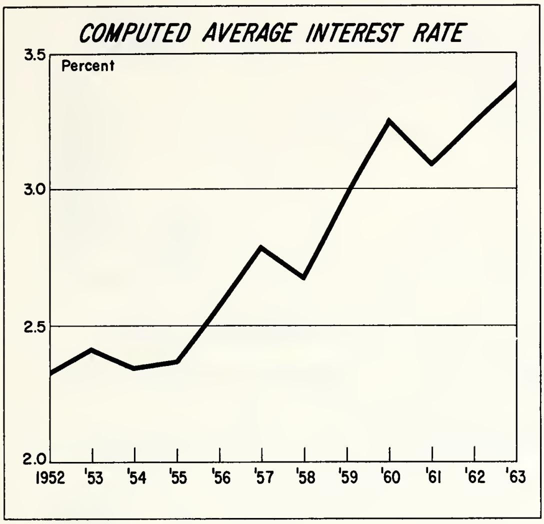
Calendar Years

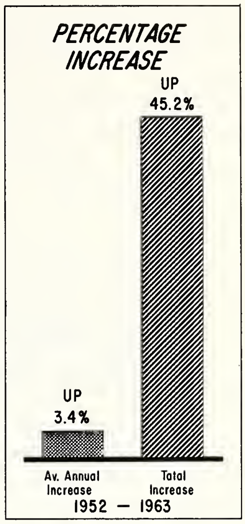


Data: Council of Economic Advisers

AVERAGE INTEREST RATES ON FEDERAL PUBLIC DEBT, 1952-1963

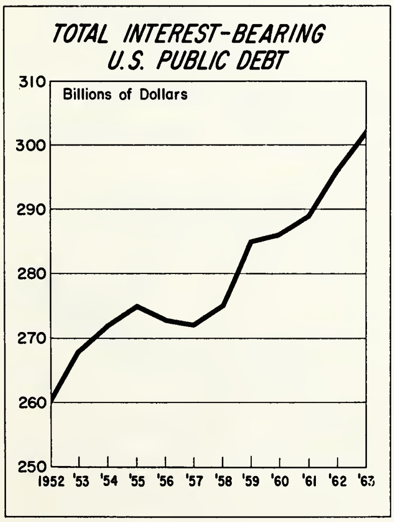
Calendar Years

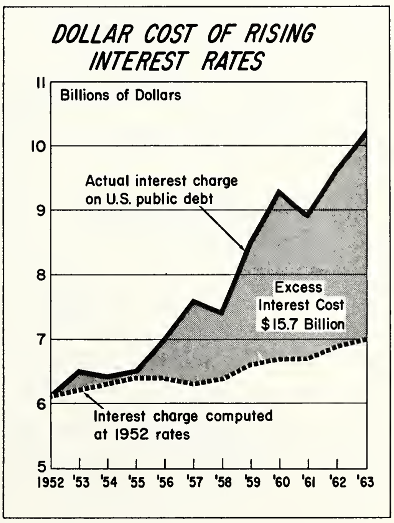




COST OF RISING INTEREST RATES TO U.S. GOVERNMENT, 1953-1963

Calendar Years

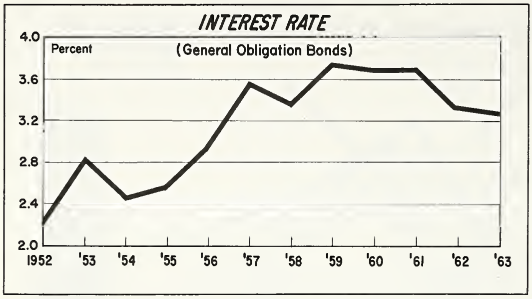


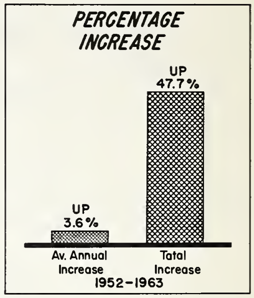


NOTE: All figures relate to total amounts outstanding.
Data: U.S. Treasury

INTEREST RATES ON NEW BORROWINGS BY STATE AND LOCAL GOVTS., 1952-1963*

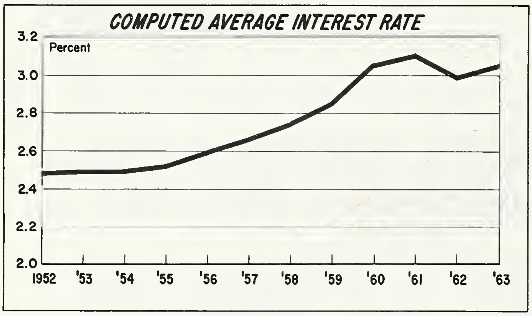
Calendar Years

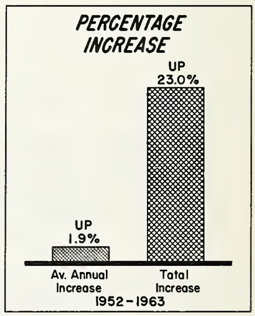




INTEREST RATES ON TOTAL DEBT OF STATE AND LOCAL GOVTS., 1952-1963*

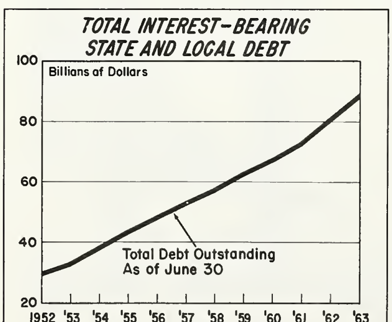
Calendar Years

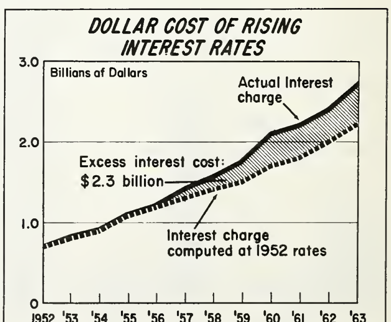




COST OF RISING INTEREST RATES TO STATE AND LOCAL GOVTS., 1953-1963*

Calendar Years





* 1963 data are preliminary estimates by the Conference on Economic Progress.
Other data: Office of Business Economics, Department of Commerce and Council of Economic Advisers.

III. The Direct Toll Of Rising Interest Rates Upon Private Borrowers

In some ways, the most serious burden of rising interest rates is imposed upon private borrowers. This is particularly distressing in an economic system devoted to enterprise and initiative. For these qualities of enterprise and initiative mark business and personal borrowers far more than those who lend money to them.

The direct toll upon all private borrowers

The first chart following this chapter on page 15 shows that the average interest rate on the total interest-bearing private debt outstanding increased 19.3 percent from 1952 to 1963. This imposed upon private borrowers as a whole, during the eleven-year period 1953-1963 inclusive, interest costs of more than 32 billion dollars *in excess* of what they would have been if 1952 levels of interest had been maintained, or almost 3 billion dollars a year. In 1963 alone, illustrating vividly the spiraling nature of these increased interest costs, the excessive interest payments by all private borrowers were 5.7 billion dollars.

To understand fully the seriousness of rising interest charges on every dollar of private debt outstanding, it should be noted that the total outstanding interest-bearing private debt rose from 225.3 billion dollars in 1952 to an estimated 600 billion in 1963, an increase of 166 percent (contrasted with the already-mentioned 16 percent increase in the Federal public debt). From the end of 1962 to the end of 1963, it is estimated that this debt outstanding rose from 572.3 billion dollars to 627.4 billion, or 9.6 percent.

The direct toll upon home owners

In the case of all 1-4 family new nonfarm home mortgages, as portrayed by the chart on page 16, the average interest rate rose to a 1963 level 20.4 percent above the 1952 level. In view of adoption by the Federal Government during the past three decades of a wide variety of programs with the avowed purpose of bringing satisfactory housing within the reach of middle- and low-income families, it is indeed indefensible that the rise in interest rates on new home mortgages has been 27 percent in the case of the Federal Housing Administration program, and 31 percent in the case

of the Veterans Administration program, compared with only 13 percent in the case of so-called "conventional" housing.

In consequence of these interest rate trends, those who from 1952 forward contracted mortgages on 1-4 family new nonfarm housing had paid out almost 6 billion dollars *more* in interest by the end of 1963 than they would have paid if 1952 levels of interest rates had been maintained. This is enough money to build half a million or more homes for middle- and low-income families. The excess interest payments in 1963 alone were about one and a quarter billion dollars.

If one family contracted a $10,000 mortgage under the National Housing Act (F.H.A.) in 1952 at the interest rates then prevailing, and a second family contracted a $10,000 mortgage under the same Act in 1963 under the interest rates then prevailing, the total payments of the second family, because of the higher interest rates, would be almost $2,200 greater than the total payments of the first family over the life of a 30-year mortgage—these total payments including both principal and interest. On a 20-year mortgage, the total payments of the second family would be almost $1,300 greater.

And while the millions of people struggling to obtain decent housing at costs within their means have been forced to pay higher and higher interest rates on every dollar which they borrow, the total amount which they have borrowed has soared. The estimated mortgage debt contracted during each year on 1-4 family new nonfarm residences rose from 12.7 billion dollars in 1953 to 28.6 billion in 1963, or more than 125 percent. From 1962 to 1963, the increase was more than 17 percent.

The direct toll upon farmers

For six decades or longer, American agriculture has been struggling to release itself from the bondage fastened upon it by those from whom it must borrow money. The partial movement toward parity of farm income during the two decades 1933-1953 was due in large measure to the lowered cost of the money borrowed by those who, in the very nature of their occupation, carry more debt relative to income than any other important group. But from 1952 to 1963, as shown by the chart on page 16, the average interest rate on the total farm mortgage debt outstanding rose 16.2 percent. The excess interest charges, stemming from these interest rate increases alone, amounted to an estimated 455 million dollars during the eleven-year period 1953-1963 inclusive.

Here again, the burden of the increased interest cost per dollar

borrowed has been aggravated by the upward rush of farm debts. The outstanding farm mortgage debt swelled from 7 billion dollars in 1952 to an estimated 16 billion in 1963, a rise of 129 percent. The rise from 1962 to 1963 was 9.7 percent.

And the farmer has endured these grievously rising debts and the substantially rising interest rates upon them in the face of catastrophic decline in farm income. Net farm income (measured in constant 1963 dollars) dropped from 16.8 billion dollars in 1952 to 12.8 billion in 1963, a decline of 23.8 percent. From 1962 to 1963, the decline was 5.2 percent, with a considerable further decline in first quarter 1964 seasonally adjusted.

The direct toll upon users of consumer credit

Consumer credit is the type of borrowing in widest use among the American people, and the chart on page 16 also depicts the trends in this field. From 1952 to 1963, the average interest rate on total outstanding interest-bearing consumer credit rose 11.1 percent, imposing an excess interest burden of 2.6 billion dollars during the eleven-year period under review, and in the neighborhood of 448 million dollars during 1963 alone. This is a most unconscionable type of burden, because the almost two-fifths of all Americans who are poor or deprived depend most upon consumer borrowing. In fact, about a quarter of all the families and individuals in the United States, in the lower half of the income structure, spend more each year than their annual incomes after taxes, and thus increase their indebtedness each year.

The pinch of poverty and deprivation has also spurred the very rapid rise in the dollar volume of consumer credit, thus aggravating further the burden of rising interest costs per dollar borrowed. Total outstanding interest-bearing consumer credit rose from 19.9 billion dollars in 1953 to 50.4 billion in 1963, an increase of 153 percent. From 1962 to 1963, the rise was 10.8 percent, with a further very substantial rise during the first half of 1964.*

The direct toll upon small business

Small business has always been more dependent upon credit than big business, and especially so in recent years when big business has tended to finance an increasing portion of its capital needs out of retained earnings.** In 1963, small manufacturing firms with assets under $1,000,000 had a ratio of debts to assets of 39.8 percent, contrasted with 24.6 percent for manufacturing as a whole.

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* These data exclude certain types of non-interest bearing consumer credit.

** See chart on page 42 following Chapter VII.

Looking at all small manufacturing firms with assets under $1,000,000, the average interest rate on debts outstanding in 1963 was 18 percent higher than in 1952, as noted on the chart on page 16. This upward movement burdened these small manufacturing firms with an estimated 471 million dollars in excess interest payments during the eleven years 1953-1963 inclusive.

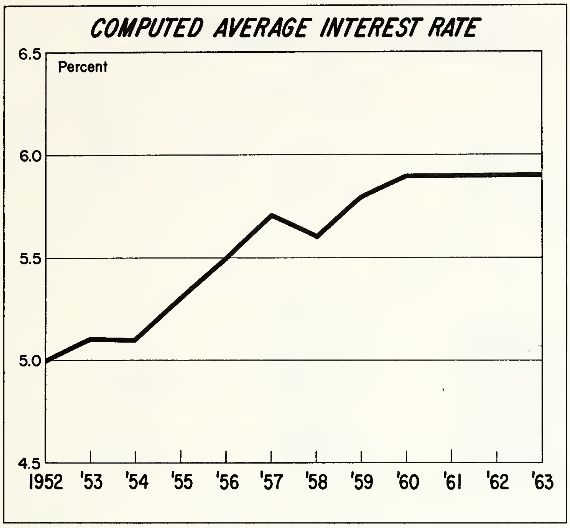
The troubles afflicting small business, compounded by rising debts and rising interest rates, are suggested by the chart on page 17. The top half of this chart shows, for manufacturing corporations, the rate of after-tax profits on stockholders' equity. During almost all of the period since 1947, and during all of the period since 1952, the rate of profits for small- and medium-size firms has been very much lower than for large firms. In 1963, the rate was 8.2 percent for firms with assets under $1,000,000 and also for firms with assets ranging from $1,000,000 to $100,000,000, while the rate was 10.3 percent, or more than 25 percent higher, for firms with assets over $100,000,000.

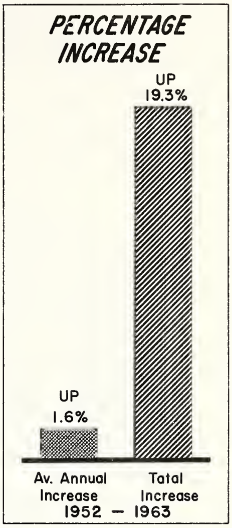
Of even greater significance in evaluating the consequences of excessively costly credit and tight money (which means insufficient credit for those who need it most) is the lower half of the same chart, dealing with business failures. Looking at failures per 10,000 firms in all size classes, the number of failures rose from 14.3 in 1947 to 33.2 in 1953 and 56.3 in 1963. Arranging these same 10,000 firms by size classes, the number of failures of firms with current liabilities under $100,000 rose from 12.8 in 1947 to 30.2 in 1953 and 47.7 in 1963, while the number of failures of firms with assets of $100,000 and over stood at 1.5 in 1947, 3.0 in 1953, and 8.6 in 1963. For the period 1947-1963 as a whole, more than 90 percent of the firms failing had liabilities under $100,000.

The next three charts illustrate this phase of the discussion.

INTEREST RATES ON TOTAL INTEREST-BEARING PRIVATE DEBT, 1952 - 1963*

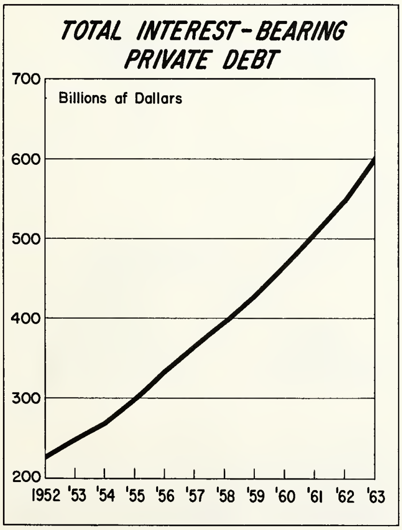
Calendar Years

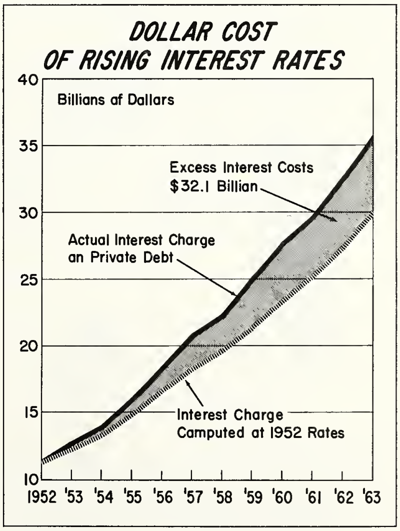




COST OF RISING INTEREST RATES TO ALL PRIVATE BORROWERS, 1953-1963*

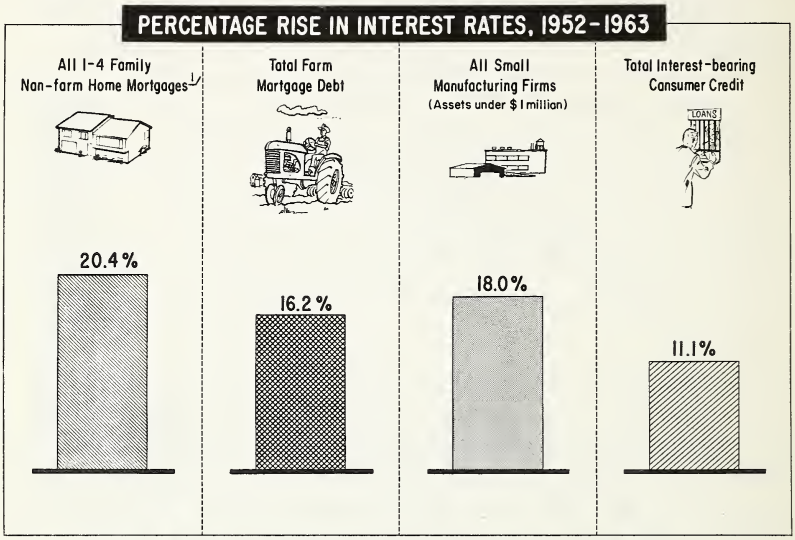
Calendar Years

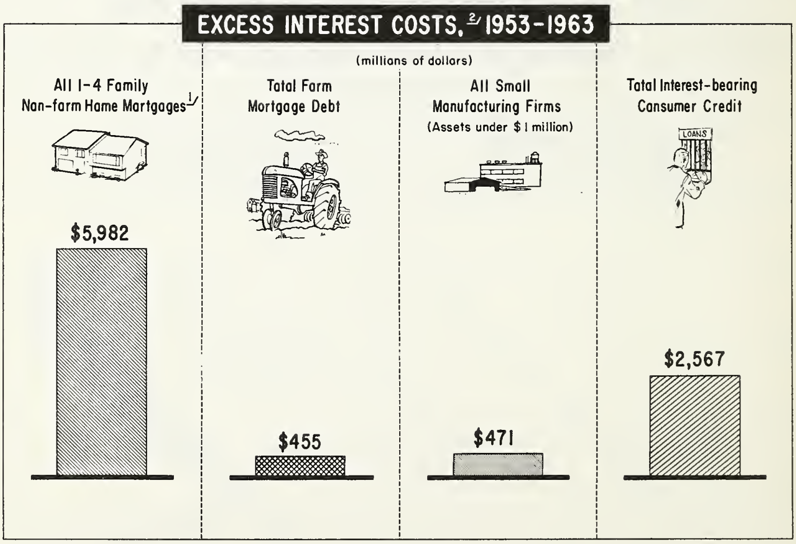




* 1961–1963 data are preliminary estimates by the Conference on Economic Progress.
Other data: Federal Reserve and Office of Business Economics, Department of Commerce.

COST OF RISING INTEREST RATES TO HOME-OWNERS, FARMERS, SMALL BUSINESSES, AND USERS OF CONSUMER CREDIT, 1953-1963



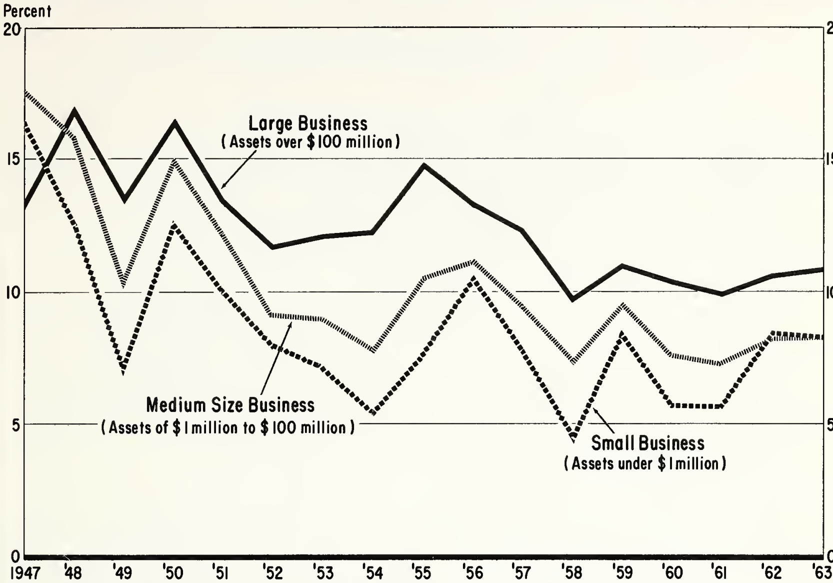


1/ Based on a weighted average for interest rates of FHA, VA, and conventionally financed mortgages.

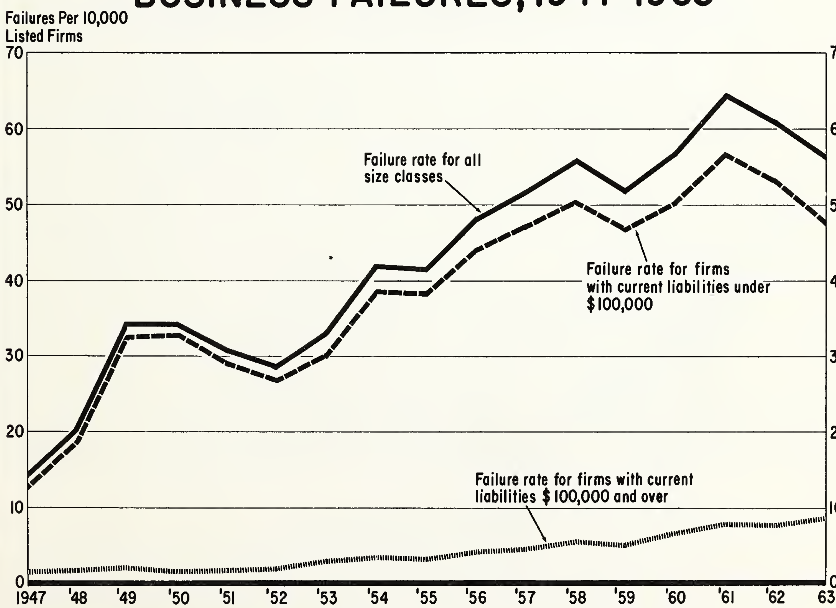
2/ Excess interest costs are based on actual interest rates compared with 1952 interest rates.

Note: Estimates by the Conference on Economic Progress based on data from the Housing and Home Finance Agency, the Veterans Administration, and the Federal Reserve.

RATE OF PROFITS AFTER TAXES ON STOCKHOLDER EQUITY MANUFACTURING CORPORATIONS, 1947-'63



BUSINESS FAILURES, 1947-1963*



* Of firms failing, more than 90% had liabilities under $100,000.
Data: FTC-SEC and President's Economic Report.

IV. The Total Nationwide Direct Toll Of Rising Interest Rates

Taking into account the outstanding interest-bearing debts of the Federal Government, the States and localities, and all private borrowers, the total public and private interest-bearing debt outstanding (as shown by the chart following this chapter on page 19) rose from 514.7 billion dollars in 1952 to an estimated 990 billion in 1963, an increase of 92 percent. It is worth pointing out again and again that the increase in the Federal debt over the same period of time was only somewhat more than 16 percent. From 1962 to 1963, the increase in the total public and private interest-bearing debt outstanding was slightly above 7 percent.

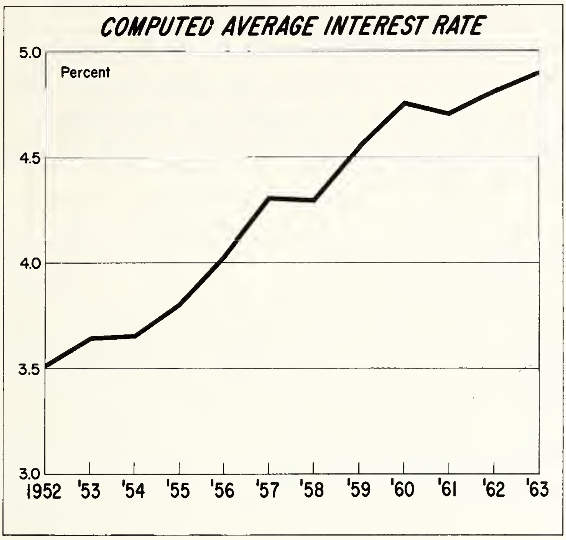
Using the actual increase in the size of the total public and private debt, instead of assuming a different rate of increase, the excess interest costs due to rising interest rates since 1952 came to the staggering total of about *50 billion dollars* during the eleven-year period 1953-1963 inclusive. For 1963 alone, this excess interest cost is estimated at the enormous figure of 9.4 billion dollars.

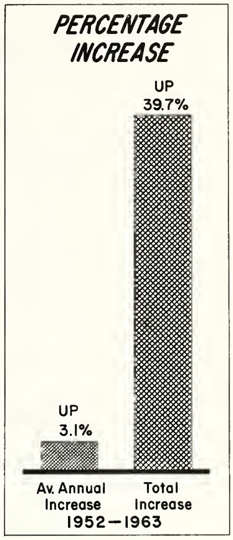
Only the completely uninformed would say that this excess interest cost of 50 billion dollars has not really cost the nation and the people anything, on the ground that the larger interest payments by borrowers have meant equivalent gains for lenders. Any such argument is equivalent to asserting that it makes no difference at all how national income is distributed or redistributed, and that the deliberate use of national economic policies to decrease the incomes of those who need help most in order to increase the incomes of those who have so much more is perfectly all right. But it is certainly all wrong, through rising interest payments, to decrease the incomes of depressed farmers, struggling home owners, seriously threatened small businesses, and poor and deprived families borrowing money in order to pay their bills, while correspondingly increasing the incomes of those as well off as the types of institutions and individuals engaged substantially in the lending of money. It is certainly all wrong to impose additional interest charges in huge amounts upon Federal, State, and local budgets—all now operating at large deficits while unable to fulfil essential public purposes—in order to pay higher interest rates to those who buy public obligations. Why all of this is so wrong will be shown more fully in the following chapters.

The following chart completes this chapter.

AVERAGE INTEREST RATES ON TOTAL PUBLIC AND PRIVATE DEBT, 1952 – 1963

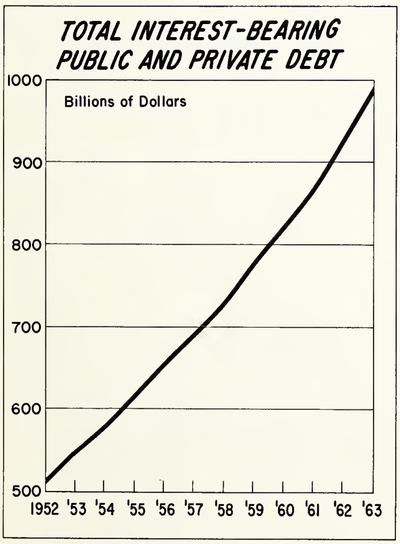
Calendar Years

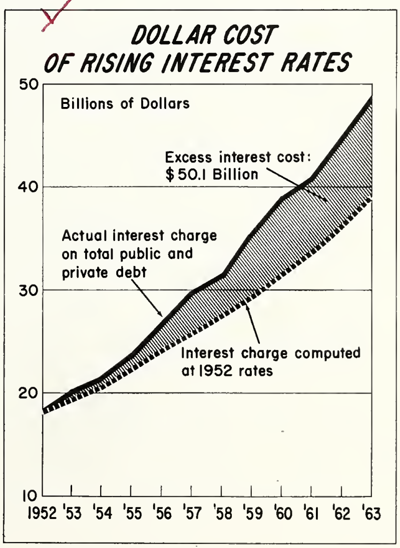




TOTAL PUBLIC AND PRIVATE COST OF RISING INTEREST RATES, 1953 – 1963

Calendar Years





Data: U.S. Treasury and Office of Business Economics, Department of Commerce.

V. How The Wasted Interest Payments Could Have Been Used To Combat Poverty

Instead of the national policies which have resulted in rising interest rates and income redistribution in the wrong direction, alternative national policies could have been used to combat massive poverty in the United States, and to serve more adequately our other national needs.

The poverty example is especially pertinent, not only because of its intrinsic importance, but also because of the magnificent determination of President Johnson to enlist the American people and our national economic policies in an all-out war against poverty.

Poverty in the United States in 1963: importance of income distribution

In 1963, as shown by the first chart following this chapter on page 24, 8.9 million American families with incomes under $3,000 and about 5 million unrelated individuals with incomes under $1,500 lived in poverty. This came to a total of about 34 million people, or not very far below a fifth of a nation. The income ceilings on the chart are expressed in 1962 dollars, because these income ceilings were suggested originally by the current Administration in the frame of reference of the 1962 price level.*

A sufficient rate of progress toward liquidating this massive poverty in the United States must depend primarily upon conditions historically associated with sustained maximum employment and optimum economic growth. The bigger the economic pie, the more there is for all. But this should not obscure the fact that the problem of poverty is closely connected with the problem of income distribution. In the neighborhood of one-third of all those living in poverty are (a) too old to participate directly in the benefits of higher employment and faster economic growth, or (b) suffer from other personal disabilities (such as being a widow with small children to take care of, or being crippled or chronically ill) which bar them from such participation in large degree. For these people, only income redistribution policies, for example, much higher social security benefits to the old and increased welfare payments to many others, which would allocate to them a

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* This study accepts these ceilings for the sake of convenience, although the earlier conference study (*Poverty and Deprivation in the U.S.*, April 1962) used ceilings of $4,000 and $2,000, respectively. However, as the lower ceilings relate only to the money income concept as developed by the Bureau of the Census, while the higher ceilings include nonmoney income as well, as developed by the Office of Business Economics (Dept. of Commerce), the use of either set of ceilings yields roughly similar results as to how many people live in poverty and who they are.

larger share of total personal income at any given time, even though they cannot earn it, will lift them meaningfully out of poverty. And even as to the approximately two-thirds of all those living in poverty whose earned incomes need to be raised through improved wage standards, more employment opportunity, and faster economic growth (with all due allowance for the value of improved training and education), it is fundamental that national policies directed toward improved income distribution are at the very foundation of the economic balance essential to maximum employment and optimum economic growth.*

Thus, the income distribution data presented on the lower half of the same chart on page 24 is extremely relevant. They show that the 18.9 percent of American families living in poverty in 1963 received only 4.6 percent of the total personal income of all families before taxes. The chart also shows that the 44.5 percent of all unrelated individuals living in poverty received only 12.8 percent of the total personal income of all individuals before taxes. Looking at the income situation after taxes would change the percentages somewhat, but would not change at all the general import of the data. This is because, taking into account State and local taxes as well as the Federal income tax, and taking into account sales taxes and other indirect taxes, the tax system in the United States is not nearly as progressive as is generally supposed, and is tending to become considerably less progressive.**

How the excess interest costs in the Federal Budget could have been used

The chart on page 25 contrasts the excess interest payments borne by the Federal Budget in calendar 1963 with certain outlays (for programs highly relevant to the war against poverty) contained in the Federal Budget for the fiscal year 1965, starting on July 1, 1964. These excess interest payments of more than 3 billion dollars were not far from twice as large as the proposed fiscal 1965 Budget outlays for education or those proposed for health services and research, a great deal larger than the proposed fiscal 1965 Budget outlays for public assistance, and more than 2½ times as large as the proposed fiscal 1965 Budget outlays for labor, manpower, and other welfare services. And if one looks at the average annual excess interest payments borne by the Federal Budget during the calendar years 1953-1963 and the average annual outlays in the Federal Budget for the same

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* A fuller discussion of why this is so occurs in Chapter VII.

** For comprehensive discussion of trends in the imposition of the whole tax burden in the U.S. since World War II and their economic and social significance, see the Conference study, *Taxes and the Public Interest,* June 1963.

vital domestic programs during the fiscal years 1954-1965, the contrasts are even more startling. Thus, if these excess interest payments had been turned to better use, they could have supported a good part of the total program needed for a full-scale war against poverty.

How the total nationwide excess interest costs could have been used

As indicated in the previous chapter, the policy of tight money and rising interest rates has imposed huge excess interest costs, not just upon the Federal Budget, but throughout the whole economy—to the extent of about 50 billion dollars during the eleven-year period 1953-1963 inclusive. Alternative economic policies, both public and private, could have used for more worthy purposes, not only the excess interest payments saddled upon the Federal Budget, but also the excess interest payments saddled upon State and local governments and upon so many crucial types of private borrowers. For example, instead of a considerable portion of the undesirable income transfers accomplished by the rising interest payments outside of the Federal Budget, enlargements of payments of a similar amount under the old age insurance system, also outside of the Federal Budget, would have transferred an equal amount of income in a highly needed direction.

The top half of the chart on page 26 illustrates this aspect of the problem. It indicates that, for the eleven-year period under review as a whole, the 50 billion dollars in excess interest costs were equivalent to more than $287 per capita for the whole population, or about $1,150 per family of four. For 1963 alone, the excess interest costs were almost $50 per capita, or almost $200 per family of four, thus indicating the rising burden per year as the years rolled by.

Desirable alternative economic policies, of course, would not have distributed this approximately 50 billion dollars equally among all families or among all individuals. Such policies, instead, would have taken account of our nationwide economic and social needs. The lower half of the same chart shows what the 4.6 billion dollar average annual excess in interest payments during the eleven-year period under review could have done to relieve poverty, if it had been used exclusively for this purpose through programs designed to increase the incomes of the poor. If this amount of money had been used to help *all* of the 8.9 million families who in 1963 lived in poverty, and whose annual incomes averaged $1,778, it could have lifted the annual income of each of these families by an average amount of $517. If this amount of money had been used to help only those 5.1 million families with incomes under $2,000, all of whom were at least

one-third below the top of the poverty-income level, and whose annual incomes averaged only $1,220, the annual income of each of these families could have been lifted by an average amount of $902. And—more hypothetically—if this amount of money had been used exclusively to help the 1.8 million families with incomes under $1,000, all of whom were at least two-thirds below the top of the poverty-income level, and whose annual incomes averaged only $630, this could have lifted the annual income of each of these families by an average amount of $2,556. The excess interest payments, if thus alternatively used, would have been sufficient to provide the same income lifts not only for the year 1963, but for *all* the years from 1953 through 1963.

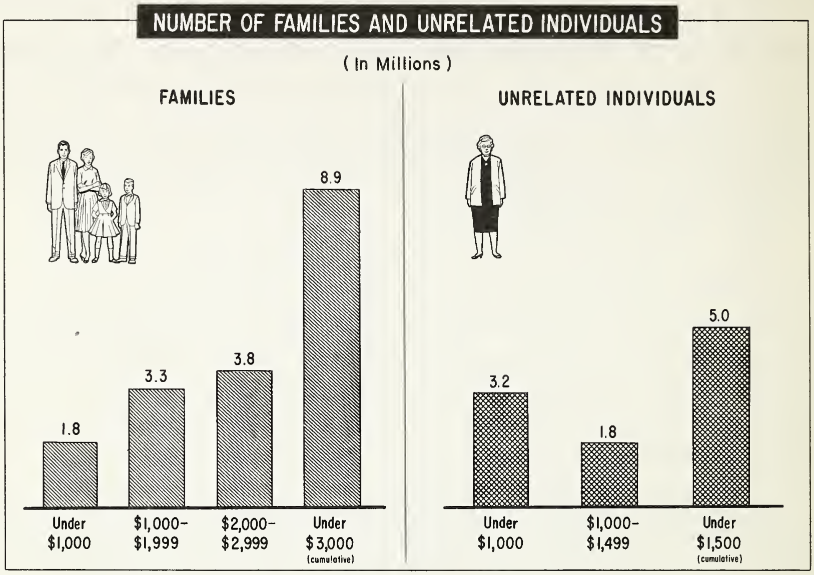
It is not suggested that it would have been desirable or possible to use the excess interest payments in precisely the ways suggested above. But the demonstration nonetheless makes it clear how wasteful and insensitive has been the use, through national monetary policy, of about 50 billion dollars in ways so remote from the most urgent of our national needs—needs identified so dramatically by the current national discourse on the subject of poverty.

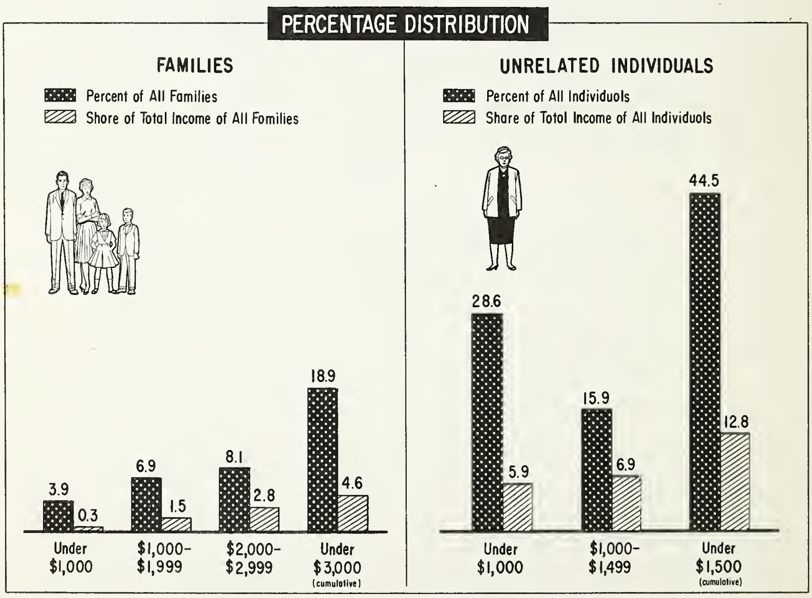
It may be objected that all of this is water over the dam. Not at all. For interest rates are still rising, and poverty is still with us. The significance of the foregoing discussion for the future is developed in Chapter X.

The three following charts round out this chapter.

AMERICANS LIVING IN POVERTY, 1963

Annual Incomes, Before Taxes, In 1962 Dollars[1]



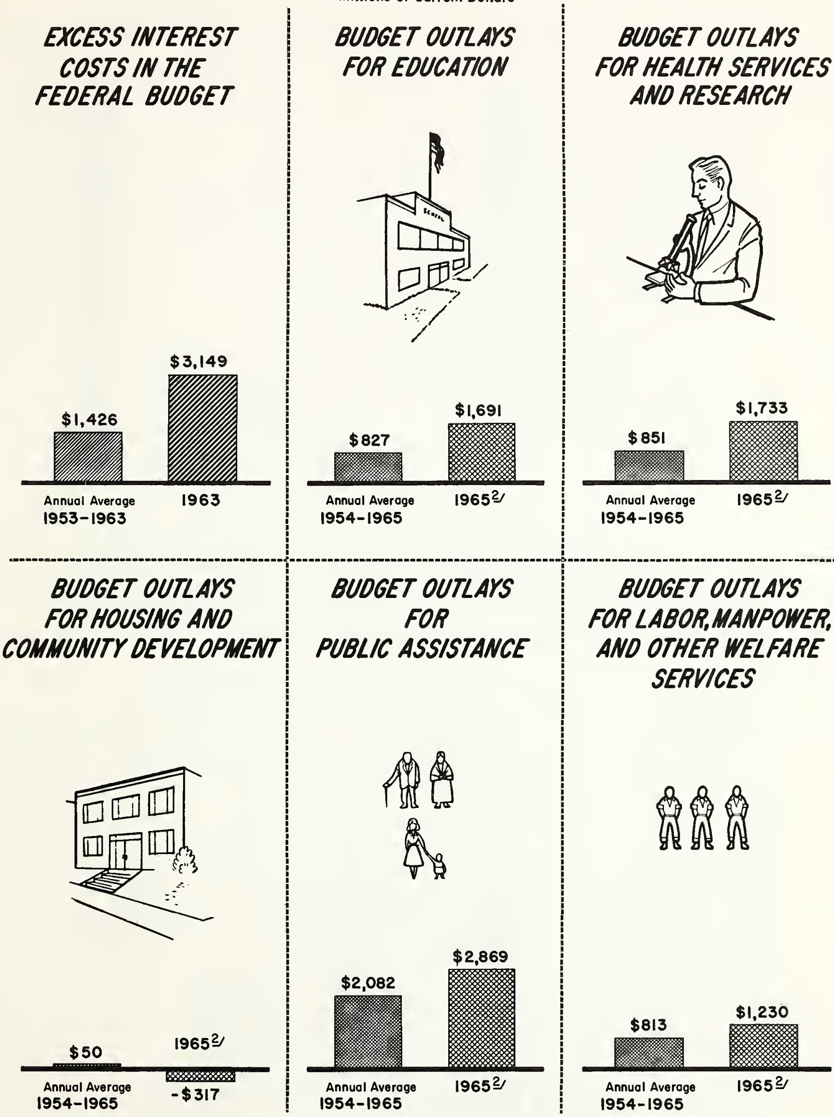


Data: Based on Census Bureau concept of money income received.

[1] The income distribution analysis is stated in 1962 dollars because the original determination of poverty income levels was made in terms of 1962 dollars.

EXCESS INTEREST COSTS IN THE FEDERAL BUDGET 1953-1963 CONTRASTED WITH OTHER COSTS RELEVANT TO THE WAR AGAINST POVERTY[1]

Millions of Current Dollars

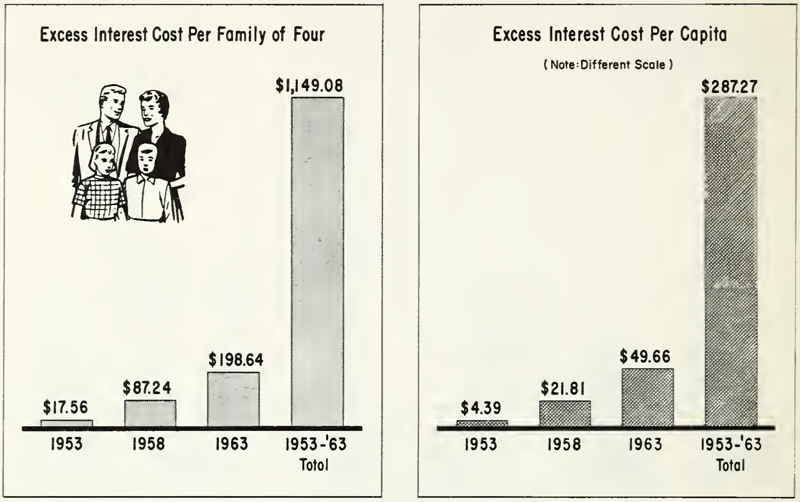


1/ Interest costs, calendar years; budget outlays, fiscal years.

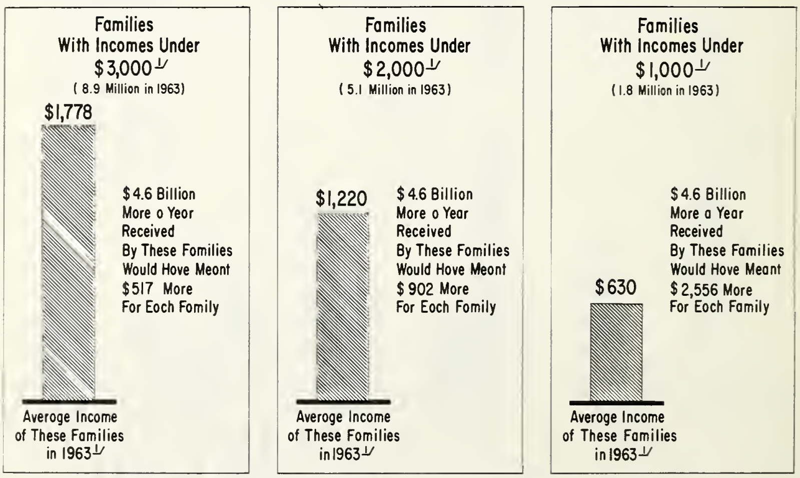
2/ Proposed in fiscal 1965 Budget.

THE BURDEN OF $50.1 BILLION IN EXCESS INTEREST COSTS, 1953-1963 UPON THE AMERICAN PEOPLE

Calendar Years



HOW $4.6 BILLION A YEAR, 1953-1963 -EQUAL TO ANNUAL EXCESS INTEREST- MIGHT HAVE RELIEVED POVERTY



Note. Family and Income data from Bureau of the Census.

1/ Income distribution analysis is stated in 1962 dollars because the original determination of the income needed to lift families above the poverty level was made in terms of 1962 dollars.

VI. Deficient U.S. Economic Performance 1953-1964

Broader consequences of the prevalent monetary policy

Thus far, we have traced the direct burdens imposed by tight money and rising interest rates. And we have examined what alternative uses of these staggering sums involved could have done to reduce poverty in the United States, and to meet other imperative national needs. But this is only part of the story. It is even more important to examine how the policy of tight money and rising interest rates has contributed to the deficient performance of the entire U.S. economy. This has been detrimental not only to the poor and deprived, but also to practically every important sector of our economic life—the people with adequate or high incomes as well as the poor, the investor as well as the consumer, the business man as well as the worker and farmer. But first of all, in this chapter, let us review the deficient U.S. economic performance itself.

The low economic growth rate, 1953-1964

The chronic rise of idle manpower and plant has been our towering economic problem since early 1953. Basically, this reflects the fact that our average annual growth rate since the end of the Korean war—measured by growth in total national production in real terms—has been far too low to make maximum use of the growing labor force in need of useful work and the rapidly advancing productivity, technology, and automation.

The first chart following this chapter on page 31 shows the average annual growth rate of only 2.9 percent during 1953-1963. This contrasts with an average clustering around 4.5 percent during several earlier periods of substantial duration when manpower and plant were in reasonably full use. Further, during these earlier periods, the advance of productivity, automation, and technology was less rapid than during the most recent years, and therefore less growth in total output was needed to maintain maximum employment and production.

The middle sector of the chart shows the prime characteristic of this poor performance—a fairly rhythmic pattern of recessions, periods of rapid economic growth not long enough (or not rapid enough) to bring us back to anywhere near maximum resource use, and then periods of very low growth, or stagnation, leading toward the next recession.

The bottom sector of the chart dispels any overconfidence that developments during the most recent years or months have thus far taken us out of the woods. The twelve-month period from first quarter 1961 to first quarter 1962 (the first such period after the most recent recession) showed a growth rate of 7.8 percent. This was very much higher than the average annual growth rate of about five percent now needed in view of the new technology and automation to keep our resources in reasonably full use *after that condition has been restored.* But it was somewhat lower than the 8-9 percent annual growth rate which was needed for at least two years from first quarter 1961 to have achieved that full restoration. Moreover, in each of the five twelve-month periods beginning with second quarter 1961-second quarter 1962 and ending with second quarter 1962-second quarter 1963, the growth rate moved consistently downward. And even with some improvement thereafter, the growth rate during any of the three twelve-month periods beginning with third quarter 1962-third quarter 1963 and ending with first quarter 1963-first quarter 1964 was only about half the rate of 8-9 percent required for reasonably full economic restoration over a two year period. Indicated trends from second quarter 1963 to second quarter 1964 do not alter the picture.

Viewing these facts, the current observation that we are "registering one of the longest uninterrupted upturns in history" neglects that a protracted recovery movement is not all to the good when it indicates failure to achieve reasonably *full* recovery within a tolerable period of time. What has really been stretched out since first quarter 1961 is not a *satisfactory* upward movement, but instead a long period of stagnation relative to the needed growth rate.

The chronic rise of unemployment, 1953-1964

The foregoing conclusions are reinforced by looking at trends in unemployment and other idle resources, depicted by the chart on page 32. To be sure, during the first half of 1964, both full-time unemployment (the type of unemployment usually discussed) at 5.3 percent * of the civilian labor force, and the true level of unemployment ** at 8.5 percent of the

* This 5.3 percent figure is very slightly lower than the figure officially reported, because this study measures unemployment as a percent of a labor force augmented by the amount of concealed unemployment.

** True unemployment also takes into account the full-time equivalent of part-time unemployment, and the concealed unemployment representing the inadequate growth in the civilian labor force due to persistent shortage of job opportunity. The 8.5 percent figure relates to a labor force augmented by this concealed unemployment.

civilian labor force, were somewhat lower than in 1963 as a whole. And in July 1964, full-time unemployment was down to 4.9 percent. But by then, we were just that much closer to the crest of the current inadequate "upturn", and unemployment was higher than at a roughly comparable point in any of the previous economic "upturns" following any of the recessions thus far since 1953. Looking at the chronically rising unemployment which has existed for more than a decade, despite fluctuations during sharp upturns, periods of stagnation, and recessionary movements, we must take account of the stage of the cycle in appraising the amount of progress toward reducing unemployment.

There are no clear signs of very much progress yet. The 4.9 percent full-time unemployment in July, 1964, was the lowest in fifty-three months. But this was a long time to get back to a level of full-time unemployment which was still intolerably high, and about 69 percent higher than the level which would be consistent with maximum employment.

The chronic rise of the production "gap"

The lower half of the same chart shows the production "gap." This "gap" represents the difference between actual total national production and maximum production. The chronically rising production "gap" evidences the chronically rising idleness of plant as well as manpower. The comments made just above about unemployment trends are equally applicable to the production "gap." In first quarter 1964, measured in uniform 1963 dollars, the production "gap" was running at an annual rate of more than 80 billion dollars, or about 11.8 percent short of maximum production.

Cause of prevalent underestimates of needed economic growth rates

This question may be asked: How can a true level of unemployment of 8.5 percent of the civilian labor force, which means excess true unemployment of only about *4.4* percent (allowing for the true level of unemployment of about 4.1 percent* which would be consistent with maximum employment) be reconciled with a total national production "gap" estimated at 11.8 percent of maximum production? The answer is that very large economic slack has led to much inefficiency in the use of the *employed* labor force, and resulted in actual productivity advances far

* This 4.1 percent includes full-time unemployment at 2.9 percent of the civilian labor force.

lower than the true productivity potential advances during the past eleven years. Thus, the production "gap" stated as a percentage of maximum production is very much higher than the excess true unemployment stated as a percentage of the civilian labor force (or if stated as a percentage of maximum employment).

This explains why the large (though inadequate) increases in total national production during the current economic "upturn" have increased employment less and reduced unemployment less than expected by those who did not realize that the "upturn" itself would tend to lift actual productivity closer to the productivity potential and thus open up fewer additional jobs than anticipated. *This means that the amount of growth in total national production required to reduce unemployment by any given amount is very much higher than that estimated by top economists in the Government. And this in turn means that more massive program efforts are essential.*

The huge losses involved in the deficient economic performance

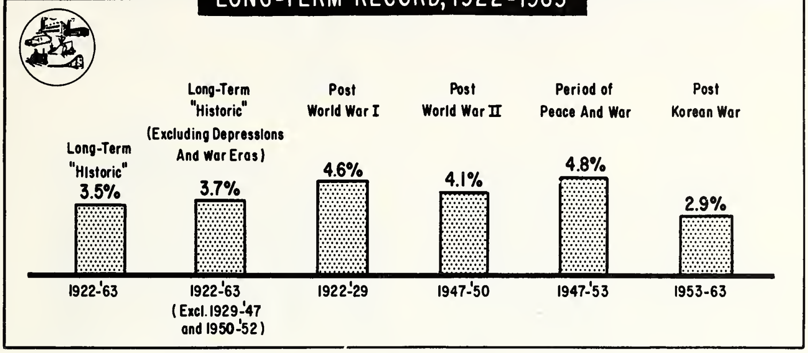
The chart on page 33 estimates that, from the beginning of 1953 through first quarter 1964, the chronically unsatisfactory economic performance caused us to forfeit about 530 billion dollars of total national production (measured in uniform 1963 dollars), and about 32 million man-years of employment opportunity (through the first half of 1964). The average forfeiture of family income for this period as a whole was about $8,300. The great forfeitures by private business investors, farm operators, wage earners, unincorporated business, professional people, and in the form of private consumption and unrealized public services, are shown on the same chart. It should be added that, at tax rates actually pertaining, governments at all levels forfeited somewhere between 125 and 135 billion dollars of tax revenues in consequence of the poor economic performance. Hence, the American people lost the opportunity to enjoy (a) substantial additional tax reductions of the right kind, and (b) very large increases in needed public services.

This discussion is reinforced by the three following charts.

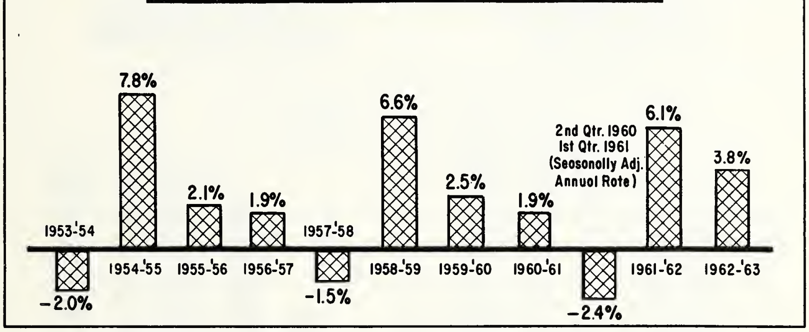
GROWTH RATES, U.S. ECONOMY, 1922-1964

Average Annual Rates Of Change In Gross National Product In Uniform 1963 Dollars

LONG-TERM RECORD, 1922-1963

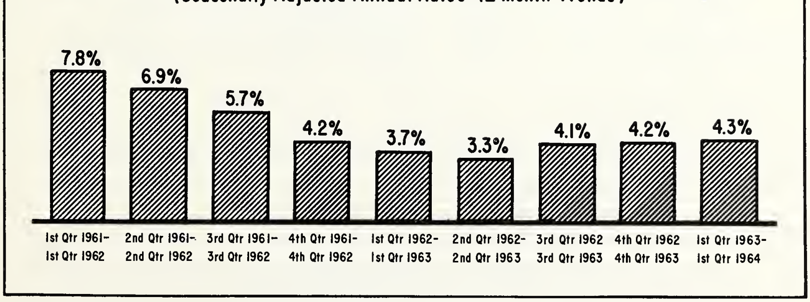


RECESSIONS, BOOMS, STAGNATIONS, 1953-1963

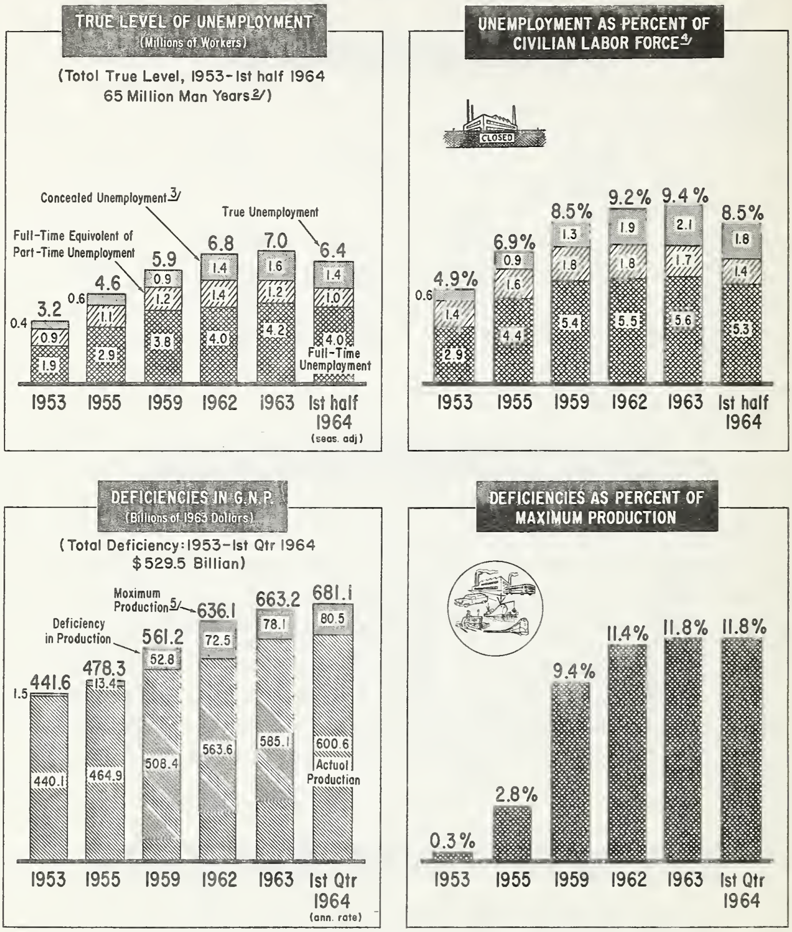


BOOM AGAIN FOLLOWED BY STAGNATION 1961-1ST QTR. 1964

(Seasonally Adjusted Annual Rates-12 Month Trends)



CHRONIC RISE OF UNEMPLOYMENT AND OF IDLE PLANT, 1953-IST HALF 1964[1]



[1] Except for the base year 1953, no year during which a recession was in process is included. First half 1964 estimated on basis of first six months.

[2] About 33 million man-years of unemployment (true level) would have been consistent with maximum employment.

[3] Estimated as the difference between the officially reported civilian labor force and its likely size under conditions of maximum employment.

[4] In deriving these percentages, the civilian labor force is estimated as the officially reported civilian labor force plus concealed unemployment.

[5] Based upon sufficient annual rate of growth in G.N.P. to provide full use of growth in labor force, plant and productivity under conditions of maximum employment and production.

LARGE NATIONAL ECONOMIC DEFICITS DURING PERIOD 1953-1 ST. QUARTER 1964

Dollar Items in 1963 Dollars

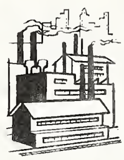
TOTAL NATIONAL PRODUCTION
(GNP)

$530 Billion
Too Low

MAN YEARS OF EMPLOYMENT 1/

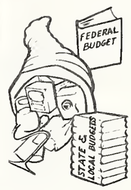
32 Million
Too Low

PRIVATE BUSINESS INVESTMENT
(Incl. Net Foreign)



$127 Billion
Too Low

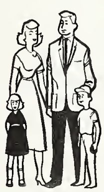
PRIVATE AND PUBLIC CONSUMPTION 2/



$403 Billion
Too Low

. . . THESE HAVE LED TO LARGE LOSSES TO ALL ECONOMIC GROUPS

AVERAGE FAMILY INCOME
(Multiple-Person Families)



$8,300
Too Low

FARM OPERATORS' NET INCOME

$76 Billion
Too Low

WAGES AND SALARIES

$348 Billion
Too Low

UNINCORPORATED BUSINESS AND PROFESSIONAL INCOME

$38 Billion
Too Low

1/ Employment Deficit is for 1953-1st. half 1964, estimated on basis of first five months.
2/ Includes personal consumption expenditures plus government (Federal, state, and local) expenditures (354 and 49 billions, respectively).

VII. Basic Reasons For The Deficient Economic Performance

Before examining how the policy of tight money and rising interest rates has contributed to the deficient U. S. economic performance since the end of the Korean war, it is necessary to examine the even broader causes of this deficient performance.

Tendency of investment in producers' facilities to outrun demand for ultimate products

When idle manpower and plant have risen chronically for so many years, it must be because the demand for ultimate products has not kept up with our ability to produce them if manpower and plant were fully used. These ultimate products are bought by 190-plus million Americans as private consumers and by governments at all levels—Federal, State, and local. Public expenditures for roads and housing and schools, and directly for personal services, while usually called public "investment," are really almost entirely demand for ultimate products, rather than investment in the basic means of production. To be sure, all of these types of public spending in one sense add to our production capabilities. Nonetheless, these types of spending are exerted against current production capabilities, and might more correctly be regarded as public consumption rather than public "investment." So, popularly stated, it might be said that our ability to produce has been outrunning consumption or ultimate demand.*

Of course, during the period since the end of the Korean war *as a whole,* private investment in the plant and equipment which add to our ever-increasing ability to produce has been too low. Almost every important form of economic activity has been too low, in an economy growing at an average annual rate of only 2.9 percent, when the needed rate was 4-4.5 percent. But in each of the recurrent economic "upturns", the rate of investment increase toward expanding the means of production has far outrun the rate of increase in private and public consumption combined. Only when the business investors have become discouraged by the amount of excess plant capacity, relative to the current and immediately prospective demand for ultimate products, has such investment been cut

* It may be said that demand for goods and services for investment purposes is also exerted against current production capabilities. True, but to expect this type of demand to compensate enduringly for investment outrunning ultimate demand as defined above, would be expecting that we be able to lift ourselves by our bootstraps enduringly.

back sharply. These sharp investment cutbacks, plus the more persistent deficiencies in private and public consumption, have brought on the recurrent recessions and periods of stagnation.

The top sector of the chart on page 39 immediately following this chapter shows an estimated average annual deficiency in investment in plant and equipment of 5.4 billion dollars for the period under review as a whole. But the lower half of the chart shows that, during the period leading up to the 1957-1958 recession, the growth rate of such investment was considerably more than three times as large as the growth rate in private and public outlays for ultimate goods and services. The unbalanced ratio was more than four-and-three-quarters to one during the period leading up to the 1960-1961 recession. The chart also shows the very drastic downturns in investment during the two recessions brought about in large measure by these relative excesses.

More immediately, during the three-year period from first quarter 1961 to first quarter 1964, investment in the means of production rose 7.2 percent, while private and public demand for ultimate goods and services rose only 4.4 percent. And even worse, from first quarter 1963 through first quarter 1964, investment rose 13.8 percent, or more than four times as fast as the 3.4 percent increase in ultimate demand for goods and services. This is one of the main reasons why the rate of economic recovery has continued to be inadequate, and why idle manpower and plant have remained so high.

There has been no shortage of profits or other investment funds

During the three recessionary periods since the end of the Korean war, the sharp cutbacks in investment were not caused by any "profit squeeze", although profits to be sure were declining, nor by any shortage of saving for investment purposes. Instead, these cutbacks were caused by the tardy recognition of business investors that their previous investment programs had been far too exuberant. And during the economic "upturns", even though investment was rising much more rapidly than the demand for ultimate products, profits (quite aside from other funds available for investment purposes) were far higher than those needed for actual investment programs, generous distribution of dividends, and adequate accumulation of reserves.

A telling demonstration of this has occurred during the current economic "upturn." As shown by the chart on page 40, during the three-

year period from first quarter 1961 to first quarter 1964, despite a general downward trend in industrial prices from levels yielding excessive profit margins, profits *after taxes* in six key areas of industrial activity increased enormously more rapidly than the increase of investment in producers' facilities. This redundancy of profits after taxes occurred even though (as already shown) actual investment itself was advancing very much too rapidly, relative to the demand for ultimate products.

Further, these relatively excessive increases in profits after taxes took place *before* the 1964 tax reductions took effect. Thus, it is hard to see how these tax reductions were needed to provide adequate after tax profits. Indeed, in recent years, retained earnings have tended to be higher than actual investment. This indicates not only the relative excesses in profits. It indicates also that demand for ultimate products relative to productive capacity, rather than the level of profits, primarily determines the rate of business investment. The same factual observations prove that there has been no need for higher interest rates to induce adequate saving for investment purposes.

This conclusion is fortified by the chart on page 41, showing the general rise in key profits after taxes to new all-time peaks through first quarter 1964. Of similar significance is the chart on page 42, showing the increasing portion of corporate funds drawn from internal sources, thus negating again the need for either tax reduction or higher interest rates to assure enough saving for investment.

One further word: There has been deep concern about the billions of American dollars flowing into overseas investment, and complicating our balance of payments and gold problem. This suggests more investment funds than could be used at home. Yet our national economic policies have moved simultaneously in the direction of reducing taxes and increasing interest rates for the specified purpose of enlarging the funds available to these same investors!

The deficiency in private consumer spending and incomes *

Because the lag of private and public consumption behind our

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* All of the quantitative estimates of needs and deficiencies in the following discussion, and generally throughout the study, are derived from an *American Economic Performance Budget*, prepared by the Conference and corrected periodically on the basis of actual economic developments. This *Performance Budget* is in the form of a completely integrated and balanced table of the U.S. economy in action, and projected into the future, including the income flows, the product and manpower flows, the various types of expenditure flows, etc. The Federal Budget, on both the tax and spending side, is a part of this *Performance Budget.*

increasing ability to produce is at the core of our chronic economic difficulties, and because private consumption is a much larger portion of total economic activity than public consumption, the deficient rate of growth in private consumer spending is our dominant economic problem. As shown by the chart on page 43, in all years but two since 1953, the actual rate of growth in private consumer spending has lagged behind the needed rate—on occasion slightly, but usually very severely. Even during the most recent years and months, a substantial lag in consumer spending existed. The lower half of the same chart shows that, by first quarter 1964, more than three quarters of the total national production deficiency was a deficiency in private consumer expenditures.

The belief in some quarters that consumers have adequate incomes, and are not spending enough because they elect to save too much, is entirely incorrect. The chart on page 44 reveals the very intimate relationship between the inadequate rate of growth in private consumer spending and the inadequate rate of growth in total personal income after taxes. From the beginning of 1953 through first quarter 1964, it is estimated that a private consumption deficiency of 354 billion dollars (uniform 1963 dollars) stemmed from a deficiency in consumer income before taxes of 450 billion, allowing for the taxes paid by consumers and consumer saving.

In addition, the unsatisfactory distribution of total consumer or personal income, and the regressive trends in recent years, have contributed mightily to the pattern of underconsumption relative to oversaving for investment purposes. This is because families and individuals in the lower sectors of the income structure spend almost all that they earn after taxes or go into debt on net balance, while higher income groups save a larger portion of their incomes.

This means that tax reductions flowing so largely to corporate investors and to higher income groups, and the rising interest rates which from the beginning of 1953 to the end of 1963 transferred about 50 billion dollars of income from where it was needed most to where it was needed least, have been eminently undesirable.

The deficiencies in Federal outlays

There have been sizeable deficiencies in public outlays for goods and services at all levels of government, as indicated by the chart on page 43, with an estimated deficiency running at an annual rate of about five billion dollars in first quarter 1964. The bearing of this upon high unemployment and low economic growth has been much greater than the absolute

figures would indicate, because of the higher "multiplier" effect of public outlays upon private spending by consumers and business. Also, the nature of the new technology and automation requires far more stress upon public spending in order to cope with the unemployment problem * and the related economic growth problem—not to speak of the need for much more public spending to make a full scale attack upon massive poverty.

The responsibility for the deficient level of public spending must be attributed to Federal policies rather than to policies of the States and localities. For as shown in Chapter II, the States and localities during the past decade or longer have been straining their financial resources immensely more than the Federal Government.

However, it is not a major purpose of this study to develop the case for *more* Federal spending. Suffice it to say that, *at any given level* of Federal spending, it would be enormously beneficial to put an end to the spiraling costs of rising interest rates, and to use the money instead for purposes of economic restoration and social justice. The data illustrating this proposition were developed fully in Chapter V.

The poverty problem and the general economic problem are not separable

We are now far too prone to treat the poverty problem as a special one, separated from the problems of maximum employment and optimum economic growth. As the preceding analysis makes clear, the dominant requirement for an improved general economic performance is the much more rapid expansion of private consumption and Federal public outlays. The greatest opportunity for expansion of private consumption is to enlarge the incomes and improve the living standards of the almost one-fifth of our people who live in poverty and the approximately one-sixth who live in deprivation (above the poverty level, but below the income requirements for a minimum adequacy standard of living). Simultaneously, the greatest need for expansion of Federal public outlays (or, at the very least, for a shift in these outlays to eliminate the wasteful and stress the productive), is among those very public programs which would do most to improve the living conditions and opportunities of the poor.**

This suggests that rising interest rates, which weaken the war against poverty, weaken the whole U.S. economy.

The six following charts round out this chapter.

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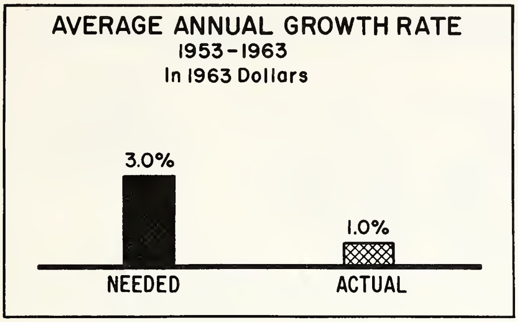
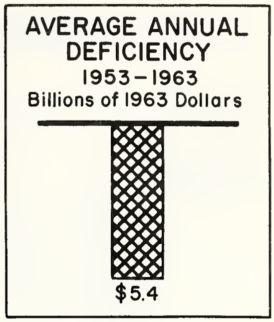
* For full discussion of this, see the Conference study, *Two Top-Priority Programs to Reduce Unemployment,* December 1963.

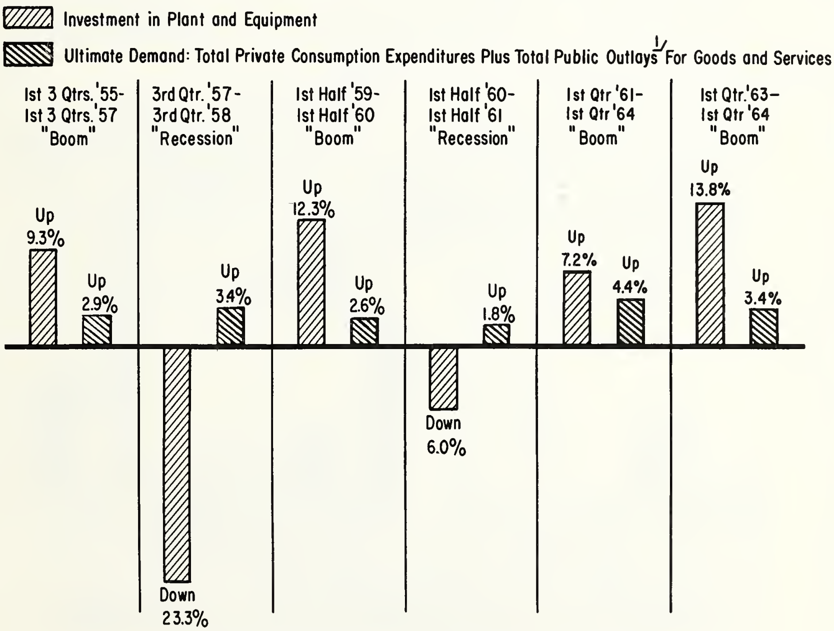
** For a full discussion, see *Poverty and Deprivation in the United States.*

INVESTMENT IN PLANT AND EQUIPMENT WAS DEFICIENT – 1953–1963 AS A WHOLE





BUT INVESTMENT IN MEANS OF PRODUCTION AT TIMES OUTRAN DEMAND; HENCE INVESTMENT CUTS AND RECESSIONS



AVERAGE ANNUAL RATES OF CHANGE

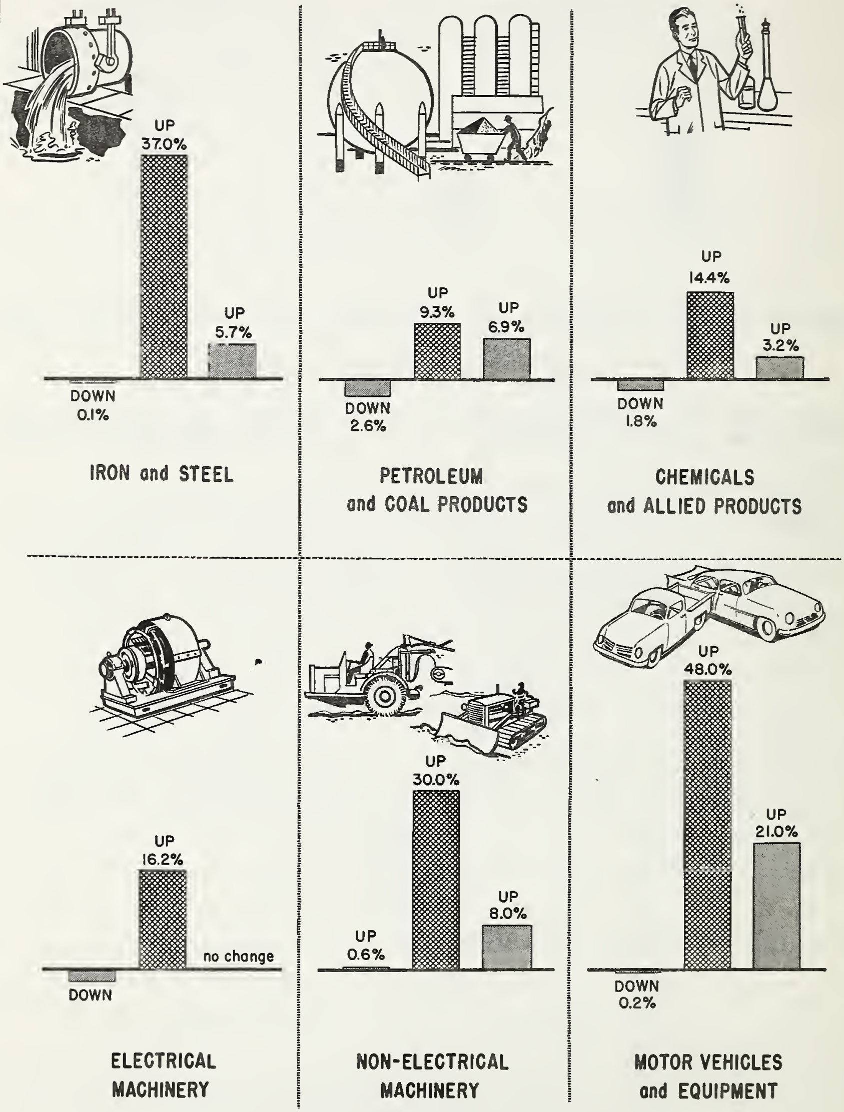
in 1963 Dollars

[1] Federal, State and local.

PRICE, PROFIT AND INVESTMENT TRENDS DURING CURRENT ECONOMIC UPTURN

Annual Rates 1st Quarter 1961 – 1st Quarter 1964

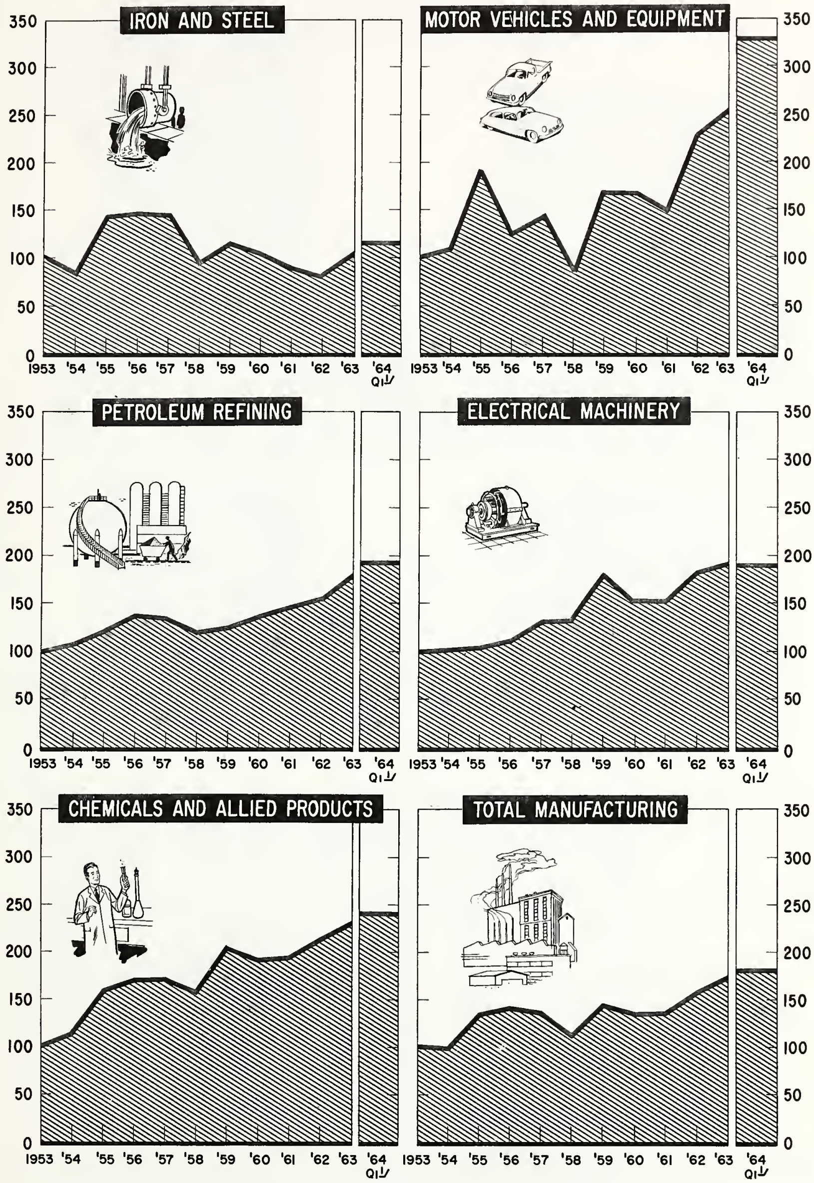
Prices;[1/] Profits after Taxes;[2/] Investment in Plant and Equipment[3/]



1/ Data: U.S. Dept. of Labor, wholesale commodity price indexes.
2/ Data: Federal Trade Commission–Securities and Exchange Commission.
3/ Data: U.S. Dept. of Commerce and Securities and Exchange Commission; seasonally adjusted.

KEY PROFITS AFTER TAXES ARE HIGH DESPITE LARGE UNUSED CAPACITIES

1953=100

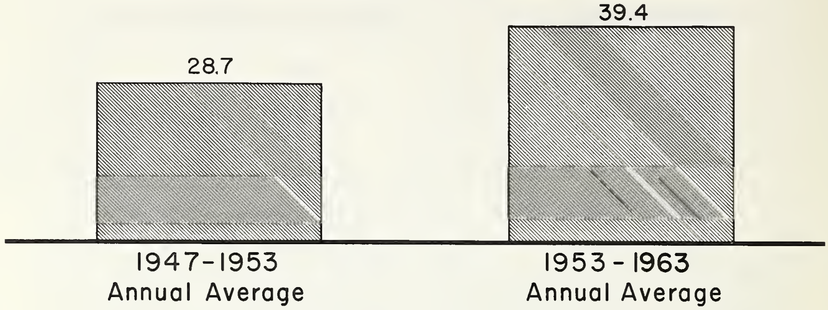


1/ First Quarter 1964 at an annual rate, not seasonally adjusted.

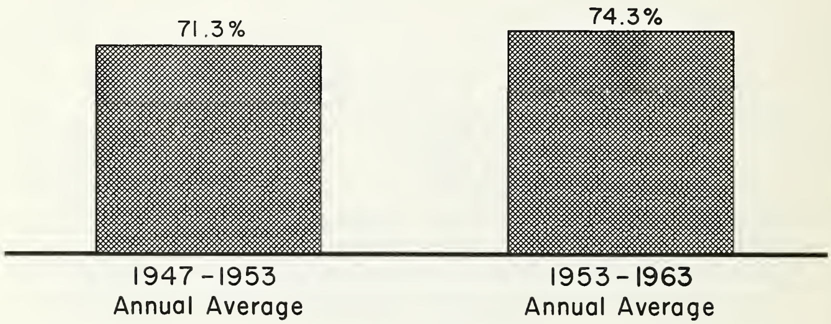
Data: Federal Trade Commission, Securities and Exchange Commission

TOTAL FUNDS USED BY CORPORATIONS HAVE INCREASED

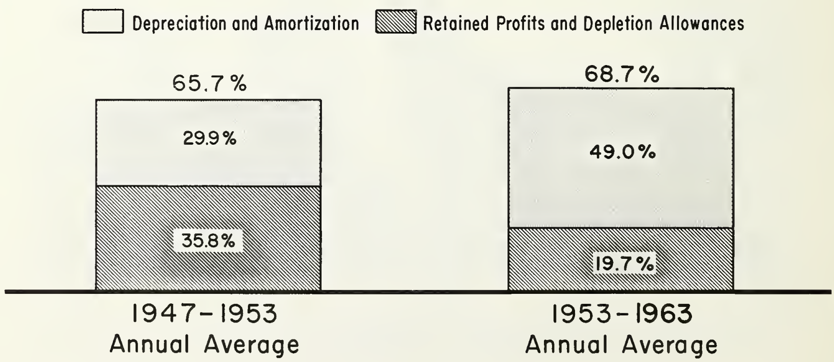
Billions of Current Dollars



PORTION OF THESE FUNDS USED FOR PLANT AND EQUIPMENT HAS GROWN



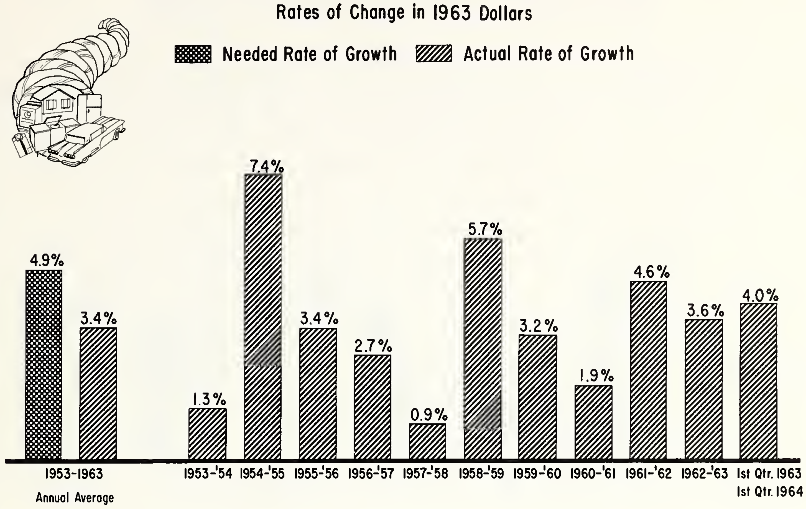
PORTION OF CORPORATE FUNDS DRAWN FROM INTERNAL SOURCES HAS RISEN



Data: Department of Commerce.

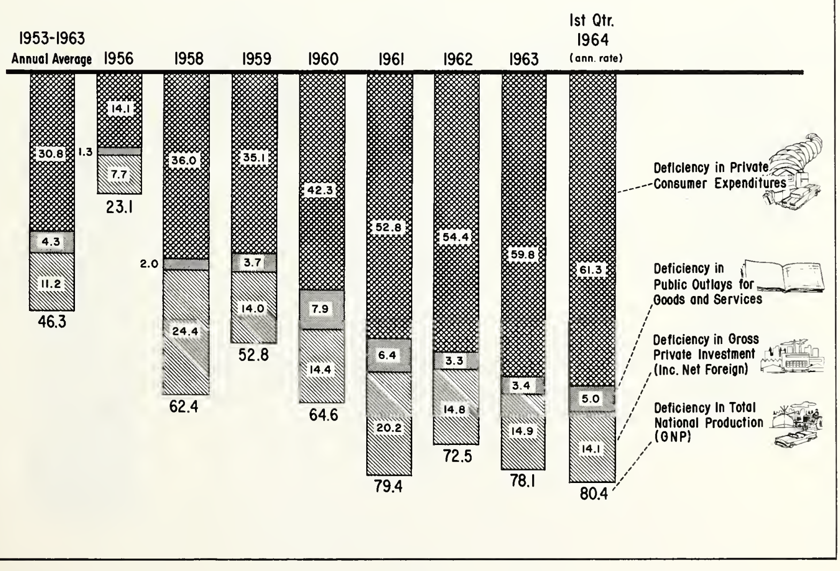
DEFICIENT RATE OF GROWTH IN PRIVATE CONSUMER SPENDING, 1953-IST QTR. 1964

Rates of Change in 1963 Dollars



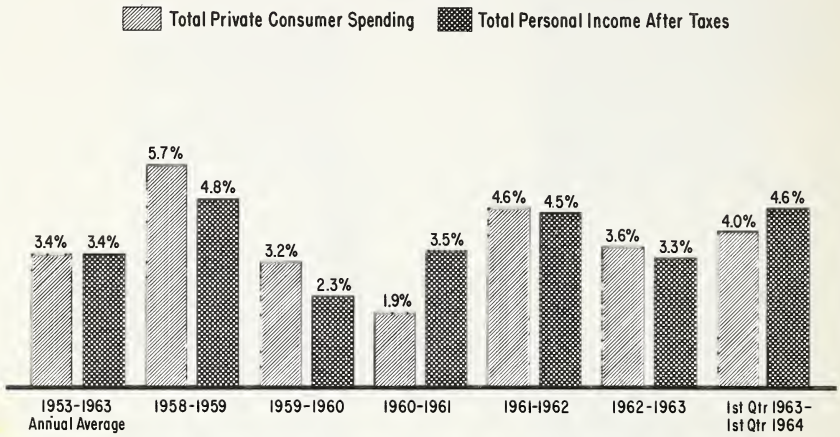
THE PRIVATE CONSUMPTION DEFICITS DOMINATE THE DEFICITS IN THE TOTAL ECONOMY

Billions of 1963 Dollars



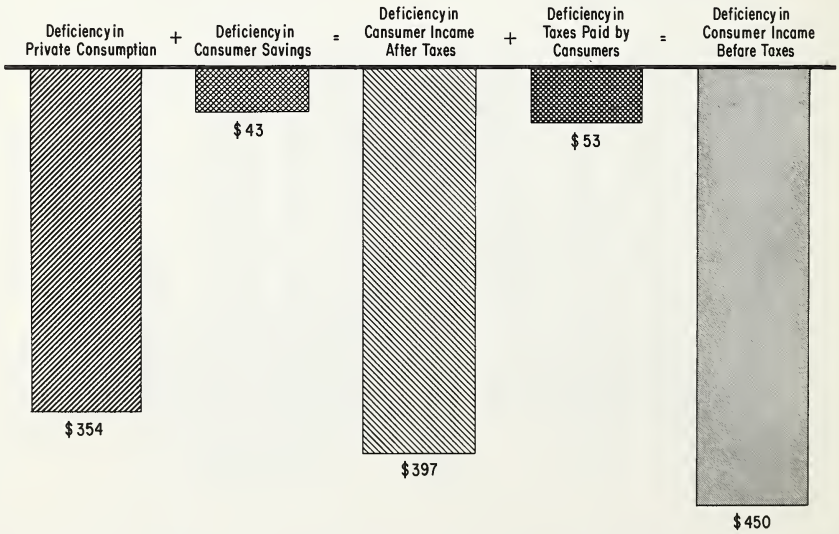
LOW GROWTH IN PRIVATE CONSUMPTION REFLECTS LOW GROWTH IN INCOMES IN MOST OF RECENT YEARS

Rates of Change in 1963 Dollars



THE PRIVATE CONSUMPTION DEFICIENCY OF $354 BILLION, 1953-1st Qtr 1964 REFLECTED A $450 BILLION INCOME DEFICIENCY

Billions of 1963 Dollars



VIII. How Tight Money And Rising Interest Rates Hurt The Whole Economy

In previous chapters, it was first shown how rising interest rates redistributed about 50 billion dollars of income in the wrong direction, on both economic and social grounds, during the eleven-year period 1953-1963 inclusive. Second, it was shown how alternative uses of this stupendous sum could have done so much to reduce poverty, and to meet other great priorities of our national needs. And third, there were some indications of how the prevalent monetary policy contributed toward our sorely deficient overall economic performance—marked by excessively high unemployment and deplorably low economic growth. Now we shall examine more comprehensively this third and most basic aspect of the damage done. This damage has had two main manifestations: Insufficient expansion of the money supply to support adequate economic performance, and redistribution of income in a manner further thwarting this adequate economic performance.

Inadequate growth in the money supply, 1953-1964

The first chart following this chapter on page 49 shows that, while total national production in real terms expanded at an average annual rate of 2.9 percent during the long period under review, the non-Federally held money supply expanded at an average annual rate of only about 1.8 percent. Both historical observation and current analysis indicate this: The non-Federally held money supply would have needed to expand at an average annual rate more than twice this fast, or somewhere in the neighborhood of 4 percent, in order to have supported a 4-4.5 percent average annual rate of overall economic expansion—that rate having been required for sustained maximum employment and production during the eleven-year period under review.*

Examination of the year-by-year trends cannot uphold any argument that movements in the money supply were merely responsive to the business cycle, and not a causal factor in the cycle. First of all, the trends in

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* Due to further advances in productivity, technology, and automation, an annual average rate of overall economic expansion of 5 percent or slightly higher would now be needed, *after* full economic restoration. Until then, obviously, a very much higher growth rate is needed.

the money supply have represented a conscious and positive national economic policy rather than a mere reaction to others events, and indeed the Federal Reserve Board has consistently championed the prevalent monetary policy and solicited credit for its consequences as interpreted by the Board. And second, in the judgment of most economists, during the years 1955-1957, and again during the years 1958-1960, extraordinarily drastic restraints upon the money supply took place and gave much impetus to the economic recessions of 1957-1958 and 1960-1961. All this is portrayed on the same chart. It would seem equally clear, although not yet so generally recognized, that the low growth rate in the money supply from 1961 forward should share blame with other policies for the inadequate reduction of unemployment and the inadequate growth rate in total national production since then—a growth rate averaging only about half that required for at least two years in order to achieve full economic restoration.

This injurious monetary policy persisted on into 1964. Contrasted with the 3.8 percent growth rate in the non-Federally held money supply from 1962 to 1963, the growth rate was only 3.5 percent from the average for the first five months of 1963 to the average for the first five months of 1964; only 3.3 percent from the first half of June 1963 to the first half of June 1964; and only 2.1 percent at an annual rate from December 1963 to May 1964. When, as already indicated, the true level of unemployment averaged 8.5 percent of the civilian labor force during the first half of 1964, this monetary restriction was utterly indefensible.

Injurious impact of rising interest rates upon income distribution

The viewpoint of this study is that the deficient U.S. economic performance since the end of the Korean war has been aggravated even more by the highly undesirable redistribution of income resulting from rising interest rates than by tight money itself—although both have been very important factors. Theoretically, at least according to classical economics, a tight money policy should result in lower prices rather than in a lower growth rate in total national production. But this classical approach ignores the stickiness of prices on the down side, due to a substantially "administered" price system not fully responsive to the law of supply and demand, and due also to other factors now operating. And it ignores the whole impact of tight money upon distribution. Our overall economic troubles (as discussed fully in the immediately previous chapter) have been due primarily to increasingly faulty income distribution, which has aggravated the tendency of our production capabilities to outrun demand for ultimate products.

Many illustrations of how rising interest rates have contributed to faulty income distribution have already been presented in this study. And the lower sector of the chart on page 50 shows that total private and public interest payments rose from about 5.2 percent of total national product in 1952 to about 8.3 percent in 1963. How this distorted the flow of national income is shown by the top sector of the same chart. Measured in uniform 1963 dollars, the total rise in gross national product was only 39 percent from 1952 to 1963. Total personal income rose only 44.4 percent, and wages and salaries only 45.5 percent, while farm proprietors' net income fell 23.8 percent. Meanwhile, dividend income, reflecting the relatively excessive profits after taxes already discussed, rose 54.8 percent, and *personal interest income rose 108.3 percent.* Viewing the redundancy of saving and other funds available for investment, as earlier portrayed, it was highly undesirable that personal interest income rise so much more rapidly than other basic elements in total personal income, and much more than 2½ times as fast as total national production.

Along the same line, the chart on page 51 shows that, comparing 1963 with 1952, while total national production measured in current dollars rose only 69 percent, the earnings of Federal Reserve member banks on their loans rose 212 percent, and their earnings on U.S. Government securities—really windfall earnings—rose 86 percent. Their net current earnings rose 100 percent, and their net profits after taxes rose 121 percent. Their cash dividends declared rose 125 percent. It is morally reprehensible, as well as economically unsound, that the rate of income progress of these financial institutions—when one consolidates the various cited indications of this advance—should be in the rough neighborhood of twice as fast as the rate of progress of the U.S. economy as a whole, measured by growth in total national production.

Recent national tax policy makes the current monetary policy even more undesirable

Many economists and other informed persons have been entirely right, when they have pointed out the gross inconsistency between (a) the huge and deliberately contrived Federal deficits involved in the recent tax reductions, designed for the purpose of stimulating employment and economic growth, and (b) the prevalent monetary policy, which works so severely against employment and economic growth. This inconsistency became even more alarming during the early months of 1964 when, as already indicated, the money supply was further tightened and interest rates driven still further upward in response to the insistence of the money managers that the

intended stimulative effects of the tax reductions should be counteracted on the ground that they posed "inflationary" dangers.

Beyond all this, the need for a more stimulative monetary policy is greatly enhanced because the tax cuts are not likely to help the economy nearly as much in the long run as many economists expected, although some of them are now coming significantly to reconsider their views. As shown by the chart on page 52, the 1962 and 1964 tax cuts of about 13.1 billion dollars allocated an estimated 6.7 billion toward stimulation of investment, and about 6.4 billion toward stimulation of consumption. The chart on page 53 shows, in addition, that these tax cuts increased the after-tax incomes of families living on the borderline of poverty with incomes of $3,000 by only 2 percent, of families with incomes of $5,000 by only 1.6 percent, and of families with incomes of $10,000 by only 2.3 percent. In vivid contrast, the after-tax incomes of families with incomes of $200,000 were increased by about 16 percent. This distribution of the corporate and personal tax cuts, in the view of this study, missed entirely the central problem of restoring a better balance between investment and consumption.

This problem is seen to be enormously greater, once it is recognized that the examination of the personal income tax rate structure which results in the immediately foregoing data does not allow for the loopholes and some other provisions in the tax laws. These loopholes and other provisions permit the very high income brackets to pay very much less in taxes than the tax rates themselves would indicate.*

The regressive aspects of the tax cuts, their limited stimulative value, and the doubtful value of deliberately undertaking additional billions of dollars of Federal deficits in exchange for tax cuts of this type, should not be compounded by adding billions of dollars more to these Federal deficits, in the form of rising interest rates which are pernicious on all scores. We cannot now undo any part of the recently enacted tax legislation; but this is all the more reason why we need to undo promptly and drastically the prevalent monetary policy.

The five charts referred to in this chapter follow immediately.

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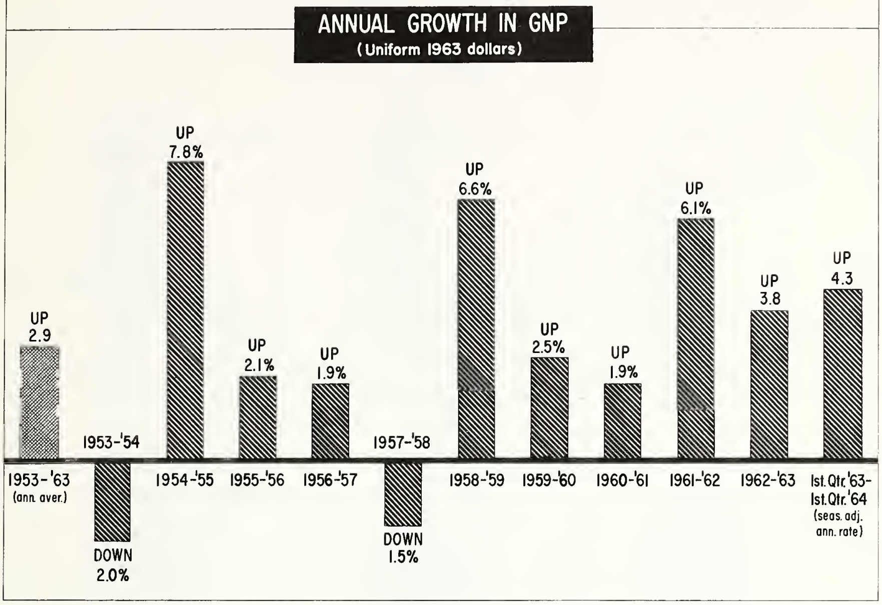
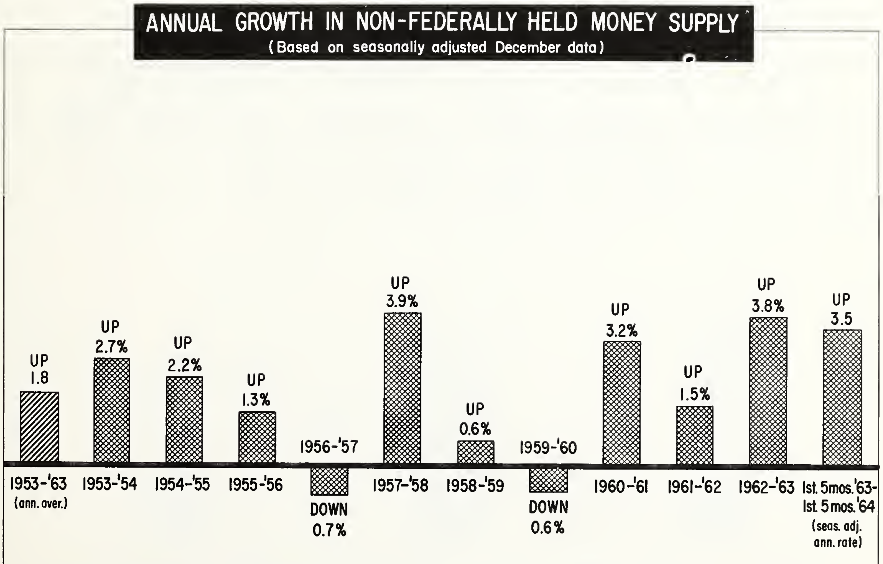
* For comprehensive treatment of the tax problem, see the Conference study, *Taxes and the Public Interest,* June 1963.

COMPARATIVE TRENDS IN GNP AND THE NON-FEDERALLY HELD MONEY SUPPLY, 1953-1964

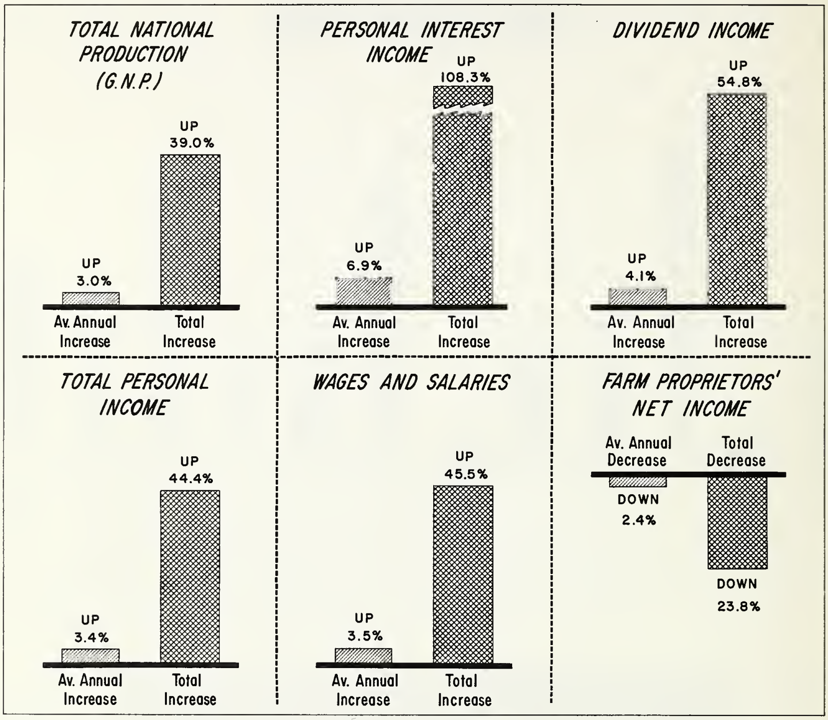




Data: Economic Report of the President

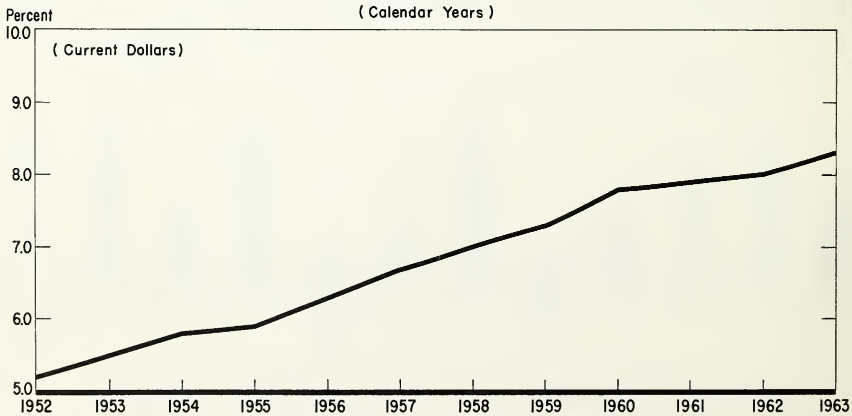
COMPARATIVE TRENDS IN PRODUCTION AND INCOMES, 1952-1963

(Percents Based on Data in 1963 Dollars)



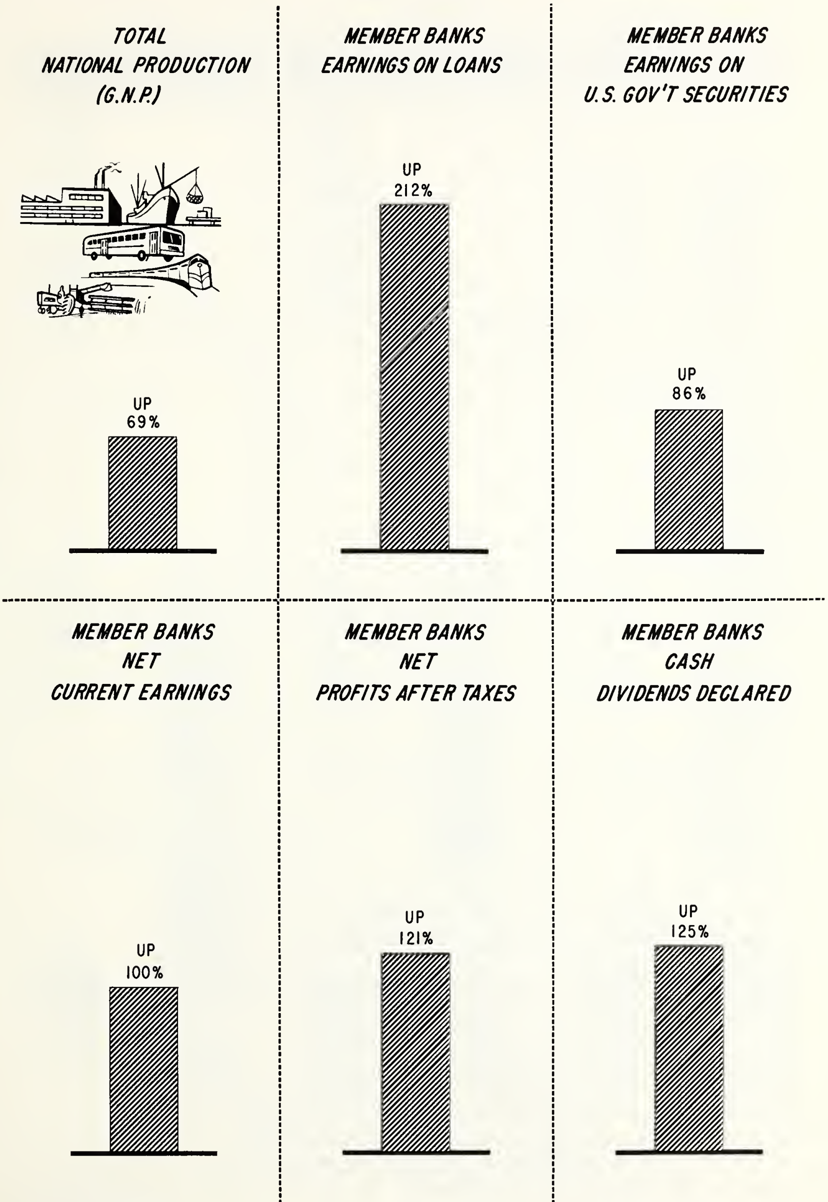
TOTAL PUBLIC AND PRIVATE INTEREST CHARGES, 1952-1963, STATED AS PERCENT OF TOTAL NATIONAL PRODUCTION (G. N. P.)

(Calendar Years)



RISE IN TOTAL NATIONAL PRODUCTION AND IN EARNINGS OF FEDERAL RESERVE MEMBER BANKS, 1952-1963

In Current Dollars

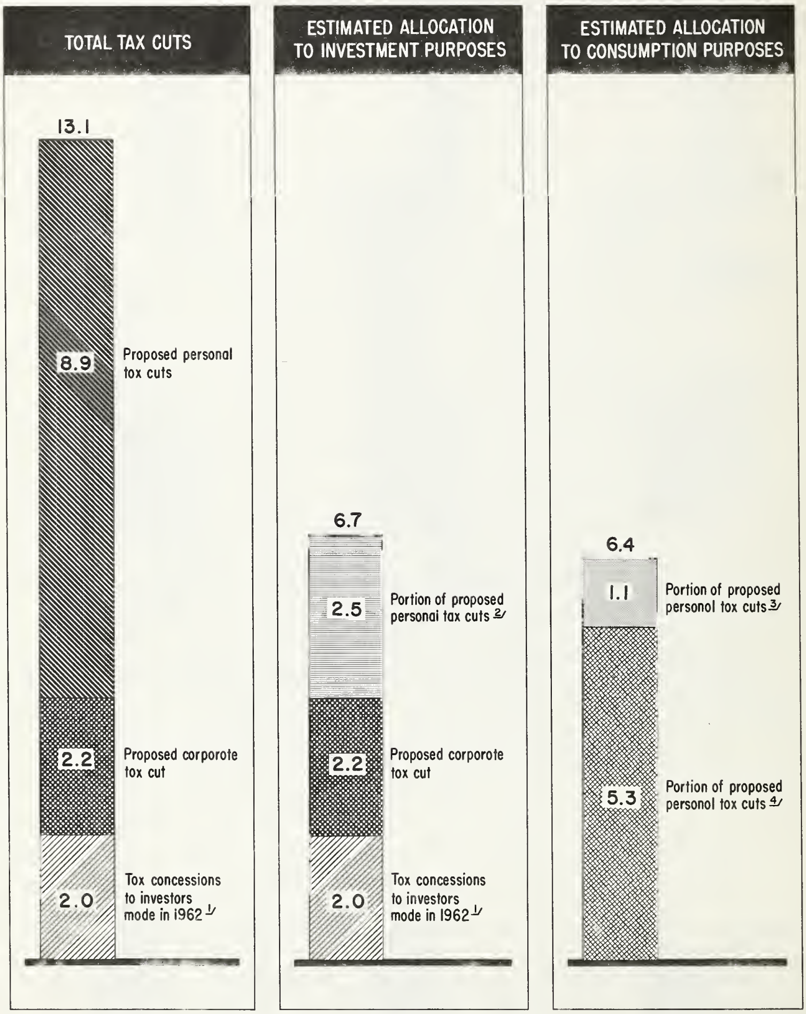


Data: Federal Reserve

1962 and 1964 TAX CUTS: ESTIMATED DIVISION BETWEEN CUTS FOR INVESTMENT PURPOSES AND CUTS FOR CONSUMPTION PURPOSES

(Including-Tax Cuts of 1962)

Billions of Dollars



1/ Through Congressional and Executive action.

2/ Estimated portion of personal tax cuts, for those with incomes of $10,000 and over, which they would save for investment purposes.

3/ Estimated portion of personal tax cuts, for those with incomes of $10,000 and over, which they would spend for consumption.

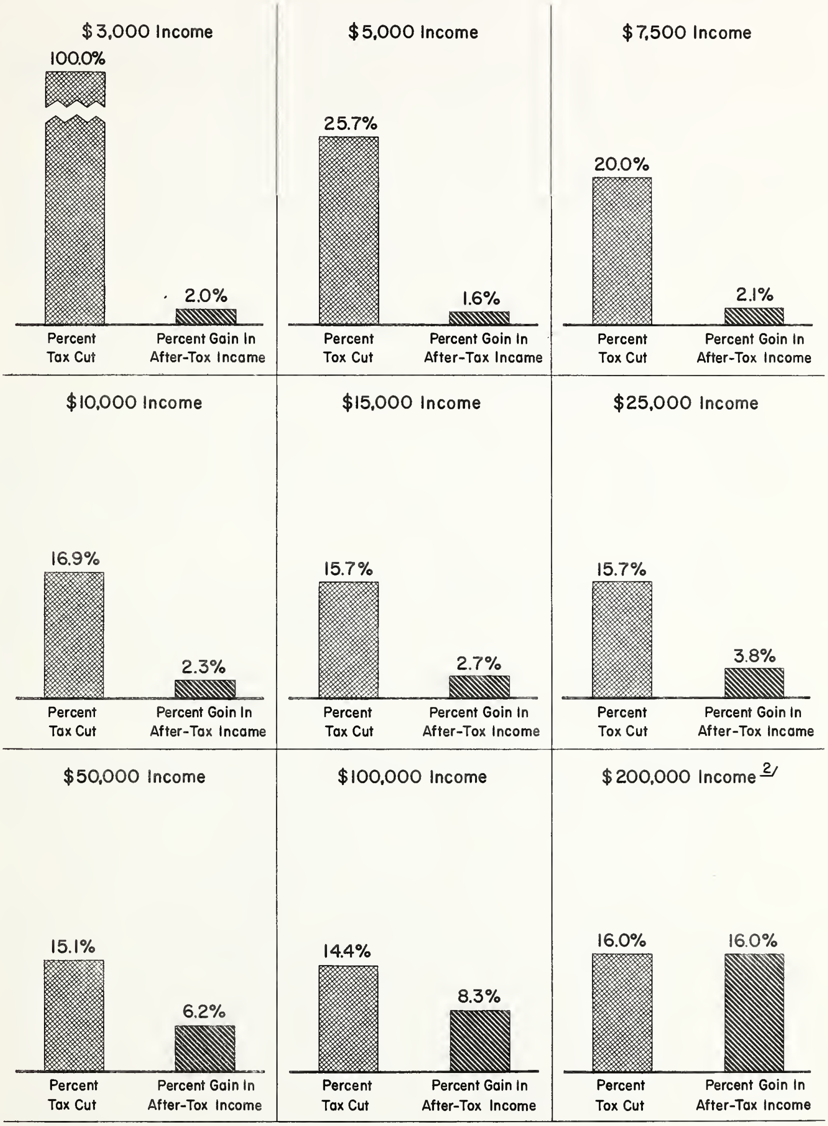
4/ Personal tax cuts for those with incomes under $10,000.

Note: Estimates of division, CEP.

1964 TAX ACT, PERSONAL TAX CUTS

Percent Tax Cut And Percent Gain In After-Tax Income

Married Couple With Two Children At Various Income Levels [1]



[1] Adjusted gross income levels. [2] Estimated

Note: Standard deductions for $ 3,000 income level. Typical itemized deductions for other income levels.

IX. The Latest "Case" For The Prevalent Monetary Policy: Inflation, Gold, And Balance Of Payments

Inconsistencies in the Federal Reserve position

The "case" made by the Federal Reserve Board and its supporters, in favor of tight money and rising interest rates, has revealed a veritable morass of inconsistencies at any one time, and sharp shifts in position from time to time. Sometimes, these policies have been promoted as the most important weapon for stimulating a faster rate of economic growth by encouraging more saving and investment; at other times, they have been promoted as the most important weapon for combatting inflation by preventing the economy from growing "too fast." Any attempt to reconcile these two positions, by the argument that avoiding inflation is the best road to sound economic growth, ignores that effective policies for speeding up and slowing down the economy cannot be the same.

At times, the apologists have said that rising interest rates are an undesirable but necessary consequence of the avowed need to tighten up on the money supply; at other times, they have urged that rising interest rates are in themselves desirable because interest rates had been "forced" too low by policies during the thirties and forties, or desirable to combat the gold outflow. At times, we have heard that the rising interest rates have not been sought by the Federal Reserve Board, but instead have been needed to enable the Government to borrow the money it has had to borrow; at other times, the Federal Reserve has claimed credit for engineering these rising interest rates as a good thing.

Along with these inconsistencies, there have been some confessions of error, unfortunately not accompanied by compatible changes in policies. In early 1957 before the Senate Finance Committee, the Chairman of the Federal Reserve Board insisted that the main danger was inflation, accompanied by a wide variety of shortages throughout the economy. He stated that the proper cure was rising interest rates, in order to promote more saving and investment in producers' facilities, and to put brakes upon consumption. This was urged at a moment when the economy was in almost universal "oversupply" relative to ultimate demand, and when the signs of the most serious recession experienced since the end of the Korean war were everywhere apparent.* In 1958, before the same Committee,

* See the Conference study, *Consumption-Key To Full Prosperity,* May 1957.

the same Chairman, viewing the recession his policies had helped so much to induce, admitted that the trouble had been insufficient consumption and relatively excessive investment.

There were even times when the Federal Reserve Board advocated tight money and rising interest rates to restrain excessive investment (inconsistent with its advocacy of the same policy at other times to encourage more investment). But thereafter, important experts in the Federal Reserve admitted that the policy was not selective enough to have any appreciable effect upon investment of the kind which was moving forward too rapidly, in view of the ample availability of funds for this purpose in any event. These experts also acknowledged that the policy resulted mainly in repressing those types of investment which were moving forward too slowly, and intimated the need for a much more selective use of monetary policy. That more selective use has not been forthcoming.

In view of full coverage in earlier chapters, it is unnecessary to dwell further upon those times when the Federal Reserve Board and its supporters have so erroneously advocated tight money and rising interest rates to reduce unemployment and speed economic growth. But it is necessary at this point to deal with the argument that the prevalent monetary policy has been necessary to safeguard us against inflation, and to cope with the balance of payments and gold problem.

Aside from war eras, the U. S. inflationary problem has been greatly exaggerated

As shown by the chart on page 64, most inflation in the U. S. economy has been due to war. Looking at the whole period 1929-1963, exclusion of the periods covered by World War II and reconversion and by the Korean war indicates that, during the other years as a whole, consumer prices trended conspicuously downward, and wholesale prices nominally downward, while industrial prices trended only nominally upward.*

As the war era inflations were caused by factors entirely peculiar to wartime, there is no merit in any assumption that the war era inflations would have occurred at some time anyway, even if the wars had not occurred. And while some of the consequences of the war-induced inflations are still with us, this has no bearing upon whether the United

* Going back to 1922 (the first year after the readjustment following World War I) would yield the same result. During 1922-1929, there was remarkable price stability, except for the decline of farm prices.

States economy is prone to much inflation without war.*

The "new inflation," 1952-1963, and its causes

At times within the period 1952-1963, and more specifically during the period 1955-1958, there occurred substantial inflationary movements which could not be explained by conventional economics. These inflationary movements were not due to general shortages, nor even in large part to isolated shortages; they were not due to too much money chasing too few goods; they were not due to demand straining hard against available resources or supplies. These inflationary movements indeed gave pause to all of the conventional explanations, and thus came to be called the "new inflation."

The chart on page 65 shows that, during the period 1952-1955, the growth rate in total national production and in industrial production averaged 3.4 percent and 4.6 percent, respectively. Nonetheless, there was practically no change in consumer or wholesale prices for this period as a whole, and not a large rise in industrial prices. In sharp contrast, during the period 1955-1958, averaging only a tiny increase in total national production and a decline in industrial production, and marked by a higher rate of unemployment than the previous period, all types of prices increased at an average annual rate of 2.5 percent or slightly higher. And during the period 1956-1958, with virtually no change in total national production for the period as a whole, with industrial production declining quite substantially for the period as a whole, and with the rate of unemployment still higher, the inflation of consumer prices was ten times as fast as during the period 1952-1955, industrial prices moved up much faster, and wholesale prices moved up at an average annual rate of 2.2 percent, contrasted with a nominal downward movement during the 1952-1955 period.

The same chart shows that, during the period 1958-1961, contrasted with the period 1956-1958, the rates of growth in total national production and in industrial production were quite sizeable rather than negligible or negative, while the rate of consumer price inflation was only about one-third as fast, and while wholesale and industrial prices held steady. And during the period 1961-1963, the growth rates in total national production and in industrial production were still higher than in 1958-1961, and the record of price stability really about the same. The unemployment rate in the

*For a full analysis of the inflationary problem during World War II, the reconversion period, the Korean war period, the period of the "new inflation," and more generally, see the Conference study, *Inflation—Cause and Cure,* July 1959.

neighborhood of 6 percent during the last two periods mentioned, contrasted with about 5 percent during 1956-1958, certainly cannot explain the transition from serious price inflation to commendable price stability despite so much more growth in total national production and industrial production.

This examination of the so-called "new inflation" indicates the fallacy of the attempts during these years to restrain price inflation by repressing the growth rate of the economy and thereby spawning excessive idleness of manpower and plant. For the "new inflation" has been a selective and administered price inflation, resulting not from classical causes, but rather from the attempts of those who administer prices to compensate for inadequate production and sales by higher profit margins per unit. Calling this "wage push" inflation is an attempt to broaden the indictment, but does not alter the analysis. Translating this analysis into a general proposition: An optimum and steady rate of economic growth, accompanied by reasonably full employment, would result in the long run in far less price inflation than either the hyperactivity of wartime or the erratic ups and downs in an economy averaging an abnormally low rate of economic growth, with chronically rising idleness of manpower and plant.

Thus, the recurrent efforts of the prevalent monetary policy to restrain inflation by injuring the overall performance of the U. S. economy is self-defeating, even in terms of restraining inflation. It is subject also to this charge: Preoccupied with the threat of inflation even during periods when there has been no such threat, the prevalent monetary policy has sacrificed huge amounts of economic progress. This progress would be of far more worth to the nation than restraining those moderate inflationary pressures which a more acceptable economic performance might have generated—even if one does not accept fully the thesis that a more acceptable rate of economic performance would have meant less inflation in the long run.

The new cross of gold

In late 1960, when it became palpably foolish to attempt to justify the prevalent monetary policy on the ground of any imminent inflationary threat, the money managers found and have since stressed a new "justification" for the policy: the gold and balance of payments problem.

The main arguments in support of the new cross of gold, upon which the U. S. economy has now become impaled, have started with the proposition that the unduly large outflow of gold has been connected with our unfavorable international balance of payments. Then it has been said

that this unfavorable balance has been due largely to our competitive disadvantage in world markets, in consequence of which we do not export enough more than we import in terms of trade to cover our foreign aid programs, our military expenditures abroad, etc. And it has been said that this competitive disadvantage arises in that our prices have been too high because our production costs have been too high; that our costs have been too high because wages have been too high relative to productivity; that productivity has been too low because investment in plant and equipment has been too low; and that investment has been too low because profits have been too low. Utilization of the prevalent monetary policy to deal with these alleged difficulties, through attempts to promote a higher ratio of saving and investment to total national production, has therefore been founded upon essentially the same errors in economic analysis which were used to justify the same prevalent monetary policy in earlier years.

We are not unduly "priced out of world markets"

Actually, we have not been and are not now faced by an inadequate share of the world markets in terms of the flow of goods; in other words, we are not competitively "priced out of world markets." This, and other aspects of the U. S. balance of payments, 1957-1963, are shown by the chart on page 66. Our international exchange of goods or "trade" proper has shown a very substantial "surplus" in our favor all along, representing excess of our exports over our imports. In 1963, our exports of goods and services exceeded our imports of goods and services by 5.3 billion dollars. We should indeed strive for a larger absolute volume of exports in an expanding world economy. But we could not even try to obtain an appreciably larger *share* of world exports, without acting counter to our own genuine interest in living standards elsewhere. These living standards need to rise even faster in many other parts of the world than in the United States, because the living-standards "gap" is still so great and indeed increasing, and is so real a menace to world peace and free institutions. To attempt again, as we did during the 1920's, to export unemployment to other countries, by refusing to admit that in the long run we must import practically as much as we export, would again bring down the economic roof over our own heads.

Even if it were to be conceded (contrary to reality) that we need to expand our *share* of worldwide exports, and that the barriers are high prices due to excessive business costs and low productivity, and inadequate profits and investment, the next question is why these barriers exist. As shown earlier in the discussion, these barriers have stemmed—to the

extent that they are or have been at all manifest—from the slack use of resources and low economic growth which result primarily from the very policies, including the prevalent monetary policy, that have prevented fuller use of resources and much higher economic growth. And insofar as some prices are too high, this is because we have substituted excessive per-unit profits, at an inadequate volume of sales and low capacity use, for the larger aggregate profits which would result from lower prices, higher volume of sales, and higher capacity use. Moreover, even now, our per-unit real production costs and real labor costs are in general lower than elsewhere in the world, because we still lead in labor skills, technology, and industrial development. Also, in general, our prices have been rising less than elsewhere, and our per-unit labor costs in terms of money wage rates and fringe benefits have been rising more slowly than productivity.

The real reason for the excessive gold flow

As we have been maintaining a quite favorable balance of trade in goods and services, the unfavorable balance of payments and excessive gold outflow (aside from our military outlays overseas and our foreign aid, which are dictated by other compelling considerations) result largely from outflow of certain types of American capital, and from withdrawal of foreign capital from the United States. In 1963 alone, as shown by the same chart on page 66, the net outflow of U. S. private capital was 4.2 billion dollars, or more than a billion higher than our total unfavorable balance of payments. And capital is not looking primarily for differentials in interest rates; it is looking primarily for investment and profit opportunity in an expansionary economic environment. The plain fact is that our economic performance during the past decade has been very poor when compared with that of Western Europe, Japan, and some other countries, measured by rates of economic growth, levels of idle manpower and plant, and frequency of recessions and periods of stagnation.

Moreover, the size of the unfavorable balance of payments does *not* determine the size of the gold outflow. During the year 1958, marked by economic recession, the gold drain was more than 2¼ billion dollars, although the overall deficit in our international balance of payments was only about 3½ billion. With our economy moving upward in 1959, the drain upon our gold reserve was less than three-quarters of a billion, although the overall deficit rose to 3.7 billion. In 1960, with the overall deficit rising only slightly to somewhat less than 4 billion dollars, the gold flow rose to 1.7 billion, with the rising ratio of the gold flow to the unfavor-

able balance of payments again reflecting recessionary trends. To illustrate more sharply, in fourth quarter 1960, with the recession upon us, the gold drain rose to an annual rate of almost 3.7 billion dollars, measured against an overall unfavorable balance of payments at an annual rate of about 5.7 billion. The years 1961 and 1962 showed an average annual unfavorable balance-of-payments position reduced to 2.3 billion, and an average annual gold drain reduced to 0.8 billion, with the sharp reduction both in the unfavorable balance of payments and in the ratio of the gold flow to the unfavorable balance of payments being responsive to the economic recovery movement. These comparisons make it abundantly clear that the tendency to translate dollars held abroad into gold mounts with diminishing confidence in the performance of the American economy, and falls with increasing confidence in that performance. As of this writing in mid-1964, the trends from mid-1963 forward tend to confirm the observation that a continued upward movement of the economy—even though inadequate—helps to improve substantially our position with respect to the balance of payments, and even more so with respect to gold.

The fiasco of the short-term interest rate policy

For the reasons already stated, the policy of lifting interest rates to help deal with our balance of payments and gold problem is self-defeating, because it hurts our entire economic performance. But it is important to note also that the money managers have not been able to execute satisfactorily even their own declared intent in this matter. Commencing with early 1961, the intention was declared to lift short-term interest rates, in order to deal with the gold and balance of payment problem. Simultaneously, it was claimed that long-term interest rates would be held or reduced, in order to reduce unemployment and accelerate economic growth at home. However, as shown in Chapter II, interest rates on long-term bonds and 3-5 year issues moved upward, comparing 1963 with 1961, illustrating the virtual impossibility of limiting the rise in interest rates to short-term issues. Indeed, it appears that the only reason why interest rates on long-term issues have risen less since 1961 than interest rates on short-term issues is that the short-term rates were reduced much more than the long-term rates from 1959 to 1961. In fact, in 1963, the spread between interest rates on long-term and short-term issues was greater than in 1959. And as also shown in Chapter II, during the first five months of 1964 compared with the first five months of 1963, the interest rates on new Federal borrowings rose 6.1 percent in the case of long-term bonds, and 16.5 percent in the case of 3-5 year issues. There is no consolation in the fact that the interest rates on short-term borrowings rose even more.

The lack of quantitative perspective

The most optimistic estimates are that improved economic policies might add a few billion dollars a year in the near future to overseas demand for American products. Considering that, in first quarter 1964, total demand for our products (GNP) was running at an annual rate about 80.5 billion dollars below the level consistent with maximum employment and production, the overwhelming opportunity to solve this problem is by lifting the production and living standards of our own people. It makes no sense to embrace policies which cause us to lose scores of billions of dollars of production and sales in the United States, with corresponding unemployment and idle plant, in an attempt to expand our sales overseas by a few billion dollars at most. Such policies are analogous to sticking a finger in a small hole in the dike, while we drive battering rams through the dike at manifold other points. Indeed, since we must in the long run import practically as much as we export, demands for goods and services by the American people need to expand practically as fast as our technology and plant and labor force grow. There is no other way to prevent unemployment from continuing to rise chronically at home.

Direct mechanisms to reduce the gold flow

Subsidiary to the main attack upon our own chronically poor economic performance, we need improved international mechanisms for the financing of international economic transactions and the settlement of international accounts. Application on the international front, with appropriate modifications, of something similar to what our own Federal Reserve System can be at its best, would among other things achieve a more effective "clearing house" setoff of short-term against long-term claims. Taking the latter into account, the position of the United States is not unsatisfactory. Of course, our worldwide economic position is not the same as it was shortly after World War II, and we should abandon any idea that we can remain something approximating the banker for the world, or even for the Western World. Other currencies besides the dollar need to play a larger role in the settlement of international accounts.

The significance of trends in debt management

One of the strongly avowed purposes of the drastic changes in monetary policy, following the March 1951 "accord" between the Federal Reserve Board and the Treasury, was to shift from short-term maturities toward long-term Government borrowing, as outstanding obligations became due and required refinancing. It was asserted that the increase in the average

length of maturity of outstanding Federal obligations, which would result from this shift, would be in aid of general economic stability and price stability. It is not the purpose here to discuss in detail the merits or demerits of this objective, but rather to point out that this avowed objective of the prevalent monetary policy is not being achieved.

The chart on page 67 shows that, comparing 1963 with 1952, the portion of the marketable interest-bearing Federal public debt outstanding having a maturity within one year rose from 33 percent to 41.9 percent. The portion having a maturity of one to five years fell from 34.1 to 28.5 percent, and the portion having a maturity of ten to twenty years fell from 18.3 to 4.1 percent. Meanwhile, the portion having a maturity of five to ten years rose from 9.9 to 18.4 percent, and the portion having a maturity of twenty years and over rose from 4.7 to 7.1 percent. In the overall, the average length of maturity fell from 5.67 years to 5.08 years.

It may well be desirable, under certain conditions, to shorten the average length of maturities, if this policy is used to reduce rather than increase costs to the Government. But the shortening of maturities under the prevalent monetary policy has been accompanied by efforts, achieved at least in part, to lift short-term interest rates faster than long-term interest rates. So long as this policy persists, shortening the maturities tends to accentuate the rising interest costs.

A second avowed purpose of the new monetary policy was to place a larger portion of the outstanding Federal debt outside of the banking system, and preferably in the hands of individuals. This aim was explained on the ground that the relatively large portion of the national debt which had been placed in the hands of banking institutions during World War II "monetized" the debt, and thus contributed to inflation. Without commenting on the merits or demerits of this second avowed purpose, it can hardly be said that significant progress toward it has been made.

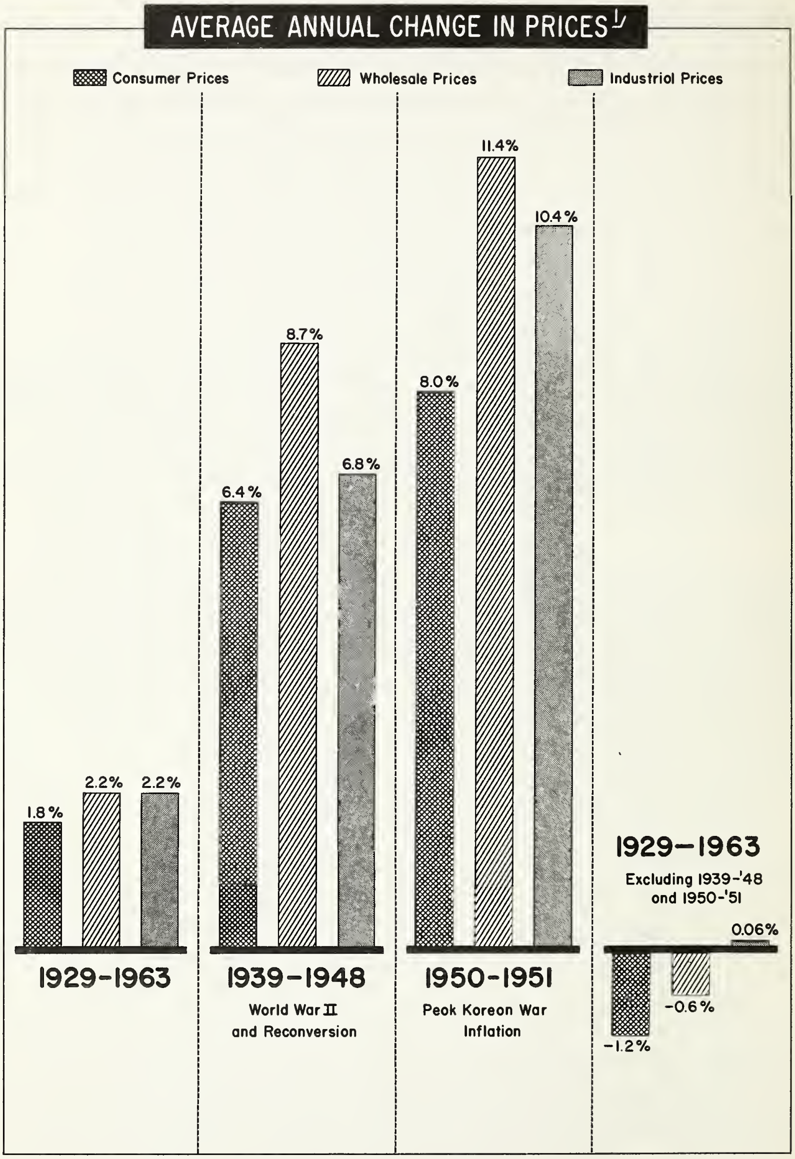
The chart on page 68 indicates that, comparing 1963 with 1952, the percentage of the total outstanding Federal debt held by the banking system declined from 36.1 percent to 33.4 percent. This might seem to represent some progress toward the avowed objective, if it were accounted for by a larger percentage of the outstanding debt being held by individuals and business concerns outside the banking system. But this has not been the case. Again comparing 1963 with 1952, the percentage of the outstanding debt held by individuals declined from 25 percent of the total to 21.4 percent, and the percentage held by insurance companies and other corporations declined from 13.4 percent to 10.1 percent.

These declines have been compensated for by the portion of outstanding Federal obligations held in U. S. Government investment accounts, which rose from 17.1 percent of the total in 1952 to 19.1 percent in 1963; by the portion held by State and local governments, which rose from 4 to 6.8 percent; and by the portion held by miscellaneous investors, which rose from 4.5 to 9.2 percent.

The trend toward holding Federal obligations in Government investment accounts is more or less a required bookkeeping transaction, resulting from legal mandates rather than from monetary policy. The increasing holdings of Federal obligations by State and local governments may represent in part their desire to get the advantage of rising interest rates on Federal issues (on earmarked and temporarily idle funds), to compensate them in small degree for the much larger amounts in interest which they are paying out to those from whom they borrow. The sharply increasing holding of Federal obligations by miscellaneous investors may well reflect in part the deplorable fact that the prevalent monetary policy, in its unpredictable aspects, has at times tended to make the prime obligations of the Federal Government more speculative than common stocks.

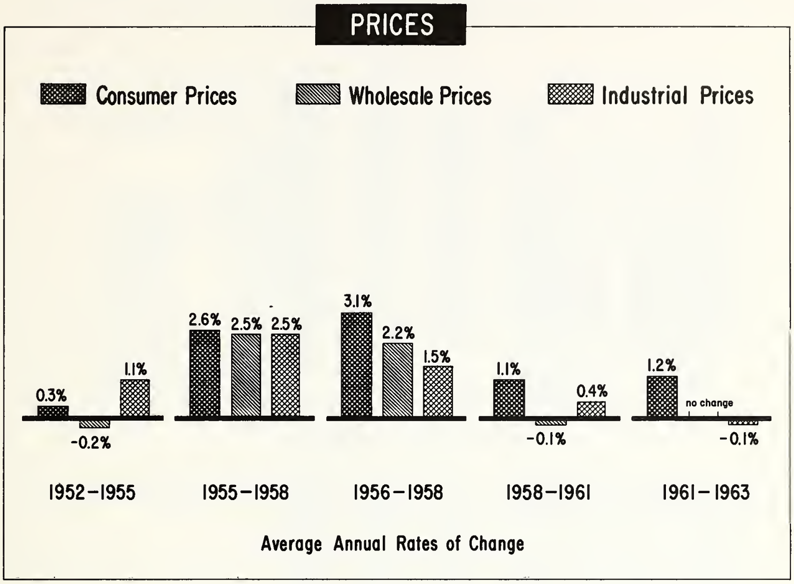
The five following charts supplement this portion of the analysis.

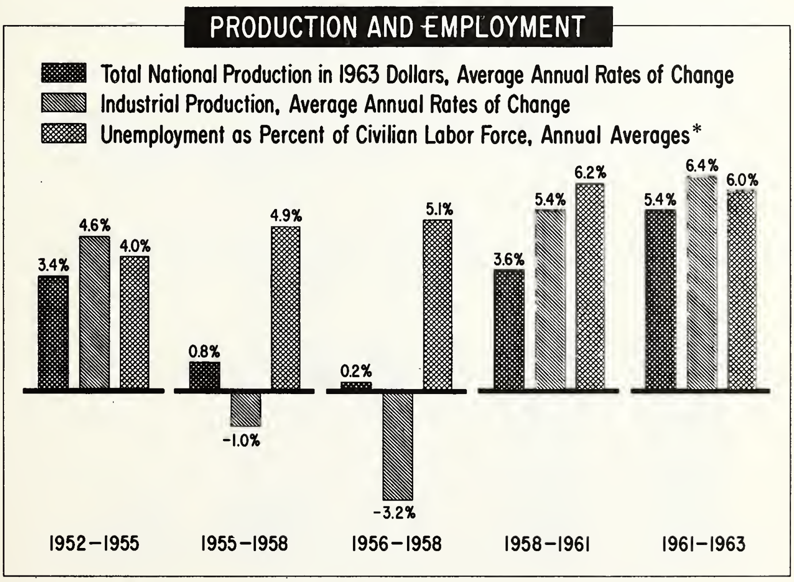
DURING PERIOD 1929-1963, MOST INFLATION DUE TO WAR



1/ The averages are based upon application of an arithmetic method to the changes from year to year, rather than upon comparisons of end years with allowances for compounding, in order to facilitate the exclusions of certain years as shown on the chart.

ECONOMIC TRENDS DURING THE PERIOD OF "THE NEW INFLATION," 1952-1963

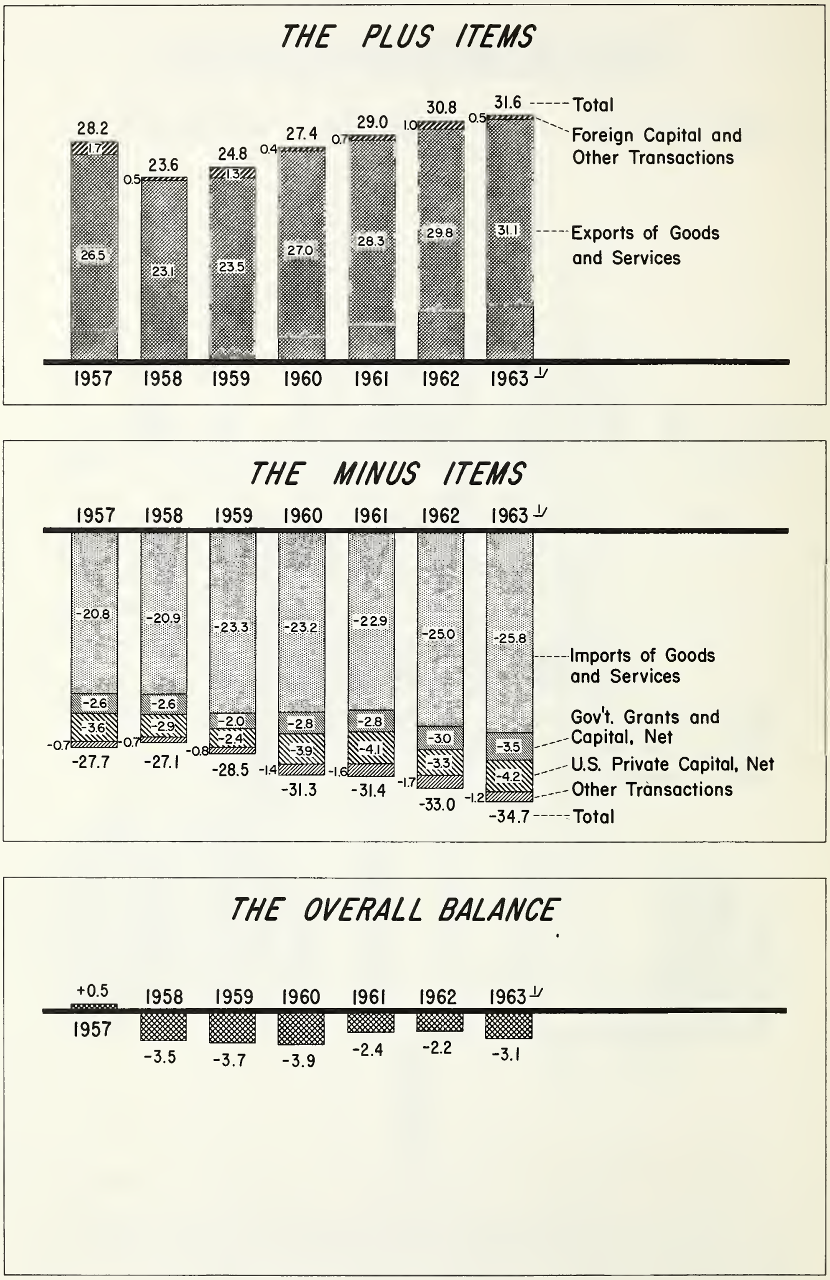




*These annual averages (as differentiated from the annual rates of change) are based on full-time officially reported unemployment measured against the officially reported Civilian Labor Force.

U.S. BALANCE OF PAYMENTS, 1957-1963 1/

Billions of Dollars

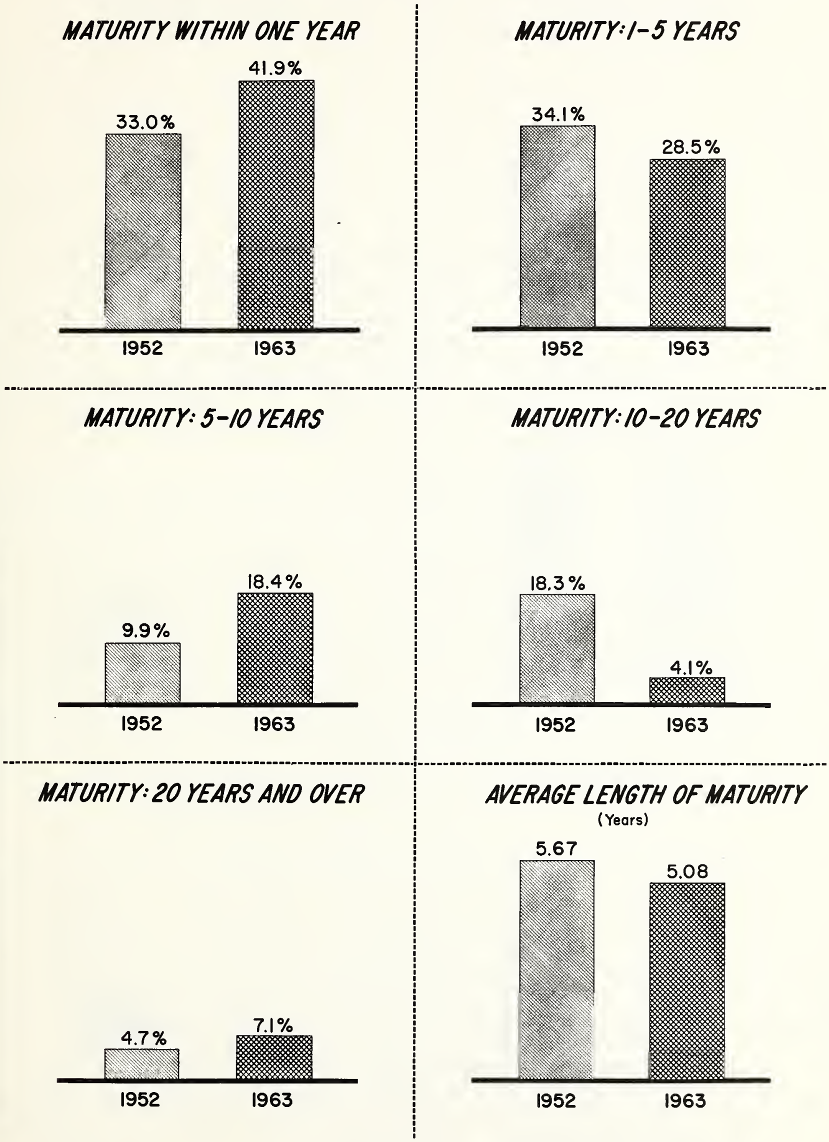


1/ Preliminary

TREND TOWARD SHORTER MATURITIES IN FEDERAL DEBT OUTSTANDING, 1952-'63

Percentage Distribution of Marketable Interest-Bearing Federal Public Debt

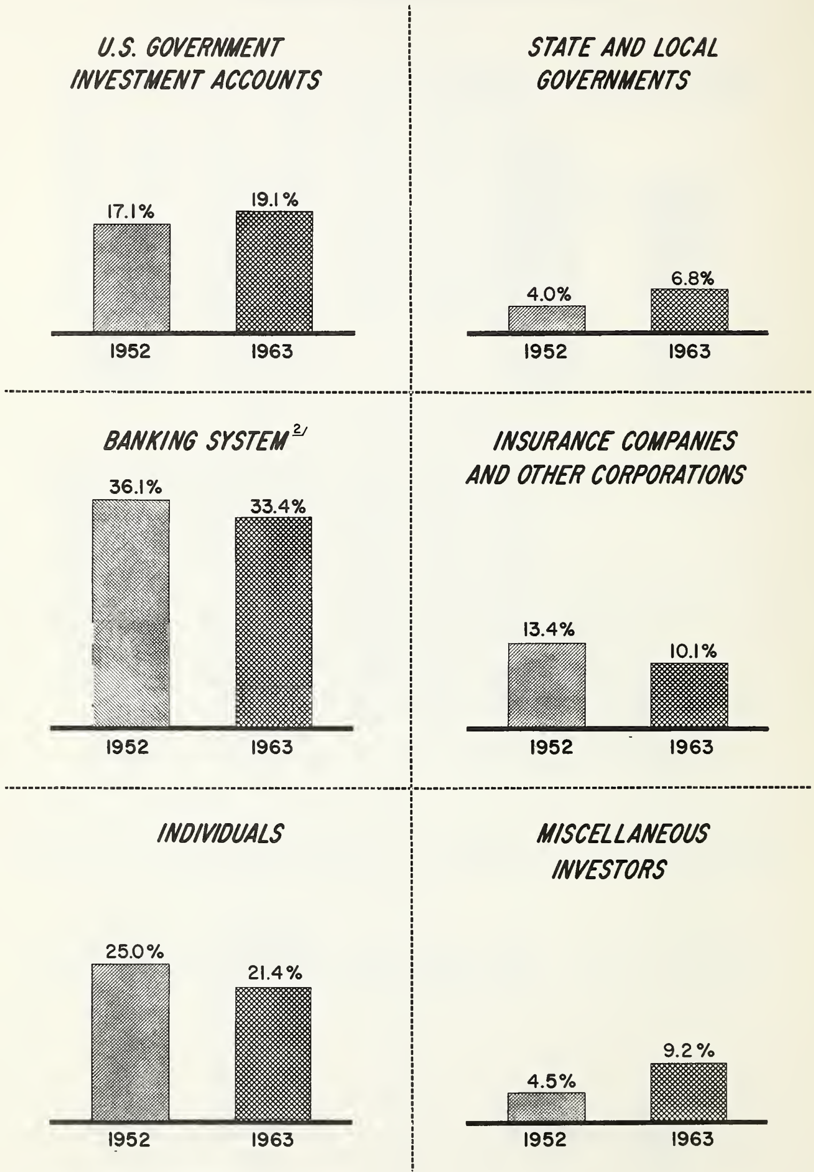
(As of June 30)



Data: U.S. Treasury

TRENDS IN OWNERSHIP OF FEDERAL DEBT, 1952-1963

(Percentage Distribution[1] As of June 30)



[1] Totals may not add to 100.0% due to rounding.

[2] Federal Reserve Member Banks, commercial banks and mutual savings banks

Data: U.S. Treasury

X. The Imminent Danger Of Rising Interest Rates In Future

The foregoing account of what has already happened is of value only as a lesson for now and the years ahead. We are still harassed by excessively high unemployment and inadequate economic growth—problems made more difficult by the accelerating advance of technology and automation. We are now more deeply committed than ever before to wage relentless war against poverty and other manifestations of social injustice in the most productive economy in all history. We still are challenged by the economic competition, not only of the totalitarians, but also of the leading free countries of the world. And we still know, in view of the tightening of the money supply and the substantial further rise in interest rates during the latter part of 1963 and the first half of 1964, that the Federal Reserve System and Board are resolutely determined to continue inflicting the damage which they have wrought during the past decade and longer. It is therefore urgently desirable to estimate—subject to the imprecisions in these kinds of estimates—the amount of damage we will suffer in future, if the prevalent monetary policy continues.

Estimated interest rate trends, 1963-1970, if the prevalent monetary policy continues

The first chart following this chapter on page 74 sets forth, in the first two sectors, the estimated trends in public and private debts, and in the interest rates thereon, if the prevalent monetary policy continues. The conservative nature of these estimates is indicated by the fact that the projections of increases in interest rates from 1963 to 1970 are at very much lower annual rates than the actual rates of increase during the past eleven years. The projected increases in debt are conservative also. Yet the bottom sector of this chart indicates these startling results:

The estimated excess interest costs * for the seven-year period 1964-1970 inclusive, are 27.3 billion dollars in the case of interest charges on the Federal public debt as borne by the Federal Budget (4.4 billion in 1970 alone); 6.6 billion for State and local debts (1.4 billion in 1970 alone); 54.8 billion for total interest-bearing private debt (9.6 billion in 1970 alone); and a grand total of 88.7 billion dollars for all public and private debt (15.4 billion in 1970 alone). Although not shown on the chart,

* Representing the difference between estimated actual interest payments and those which would have resulted from maintenance of 1952 levels of interest rates.

it should be added that the total for the seven-year period is estimated at 1.3 billion dollars in the case of farm mortgage debt (245 million in 1970 alone); 5.5 billion for interest-bearing consumer credit (1.1 billion in 1970 alone); and 917 million for small manufacturing firms with assets under $1,000,000 (170.8 million in 1970 alone).

How these future excess interest costs would impede future anti-poverty programs in the Federal Budget

The chart on page 75 estimates that the excess interest costs in the Federal Budget, standing at about 3.15 billion dollars in 1963, would rise sharply to an annual average of about 3.9 billion for the seven-year period 1964-1970 inclusive (calendar years). This latter figure comes to very much more than twice the proposed outlays in the President's fiscal 1965 Budget for education, or the proposed fiscal 1965 outlays for health services and research. It is much more than one-third higher than the proposed fiscal 1965 Budget outlays for public assistance. It is more than three times as high as the proposed fiscal 1965 Budget outlays for labor, manpower, and other welfare services. It is to be contrasted with a negative figure of 317 million dollars in the proposed fiscal 1965 Budget for housing and community development (indicating that the Government expects to take in more than it puts out on these programs). If these excess interest costs were not paid out, this in itself would yield enough money to lift total outlays for the programs just mentioned by about 54 percent above the proposed fiscal 1965 level, not just for that year, but for every year through fiscal 1971.

The entire "poverty package" is estimated to have an annual magnitude of close to one billion dollars, of which about half a billion is intended for expenditure in fiscal 1965. Thus, the fiscal 1965 allotment to the war against poverty (even aside from the fact that some other programs in the Federal Budget, highly relevant to the reduction of poverty, have been cut back) is less than one-sixth of the excess interest costs in the Federal Budget for calendar 1963, and only about one-eighth of the estimated average annual excess interest costs which will burden the Federal Budget during the calendar years 1964-1970 if the prevalent monetary policy continues.

How these excess interest costs would handicap the nationwide war against poverty

The top sector of the chart on page 76 shows that, during the seven-year period 1964-1970 inclusive, the nationwide excess interest costs

would be equivalent to more than $436 on a per capita basis for the whole population, or more than $1744 per family of four. For 1970 alone, the excess interest costs would be almost $72 per capita, or more than $287 per family of four.

The lower sector of the same chart shows that, if the 12.7 billion dollars in average annual nationwide excess interest costs during the seven-year period as a whole were applied to *all* of the 8.9 million American families living in poverty in 1963, with incomes under $3,000, and with average incomes of only $1,778, the income of each of these families could be increased by $1,427, *or more than enough to lift all of these families above the poverty level.* Here again, it should be stressed that the redirected utilization of these wasteful and injurious excess interest payments would achieve these income lifts, not for one year alone, but for every year in the seven-year period under discussion.

In short, while so many generally well-informed Americans, deeply dedicated to the elimination of the curse of massive poverty in the United States, are at a loss as to where the money is coming from to achieve this noble purpose, the fact is this: The single device of getting rid of these excess interest costs on a nationwide basis would provide enough money to stamp out by 1970 the poverty among all families in the United States, or the bulk of poverty among all families and unattached individuals as well.

Of course, it would not be practical to turn back interest rates immediately to the 1952 level, even though that would not be a larger accomplishment than the downward revisions of interest rates which were accomplished a generation ago, with such large benefits to the American economy and the American people. And it might not even be practical to get back to the 1952 level even in the longer run, although some substantial downward movement is both feasible and urgent. But even if the upward spiral of interest rates (in prospect if the prevalent monetary policy continues) were now called to a halt, this in itself would provide enough money to cover a very substantial part of the cost of a full-scale war against poverty in the United States.

In addition, calling to a halt the interest-rate spiral would contribute greatly to the restoration and maintenance of maximum employment and optimum economic growth. This contribution, allied with other desirable changes in national economic policies, might well come close to stamping out poverty within a decade.

The estimated future benefits of maximum employment and optimum economic growth

In order to appreciate the imperative necessity of abandoning the prevalent monetary policy, and coupling this with other needed efforts, let us now take a look at the differences between the results of high and low economic growth rates during the seven-year period 1964-1970 inclusive. The "high" economic growth rate is that estimated as needed to restore maximum employment and production not later than about two years from now, and to maintain it thereafter through 1970.* The "low" economic growth rate is roughly comparable to the 2.9 percent annual average during the past eleven years. This rate is used because, for reasons earlier indicated, it is by no means clear as yet that the average annual growth rate between now and 1970 will be appreciably higher than the average during the past eleven years, unless many of our national economic policies are vigorously revised.

For the seven-year period 1964-1970 inclusive, as depicted by the chart on page 77, the estimated difference in man-years of employment opportunity would be about 40 million, and more than 8 million in 1970 alone. The estimated difference in unemployment would be close to 22 million man-years for the seven-year period, and 4½ million in 1970 alone.** The estimated difference in total national production, measured in uniform 1963 dollars, would be close to 700 billion dollars for the seven-year period as a whole, and more than 163 billion in 1970 alone. The estimated difference in family income would be about $9,000 for the seven-year period, and $2,125 in 1970 alone; in wages and salaries, more than 333 billion dollars, and more than 82 billion, respectively; in net farm income, more than 95 billion, and 19.5 billion; in unincorporated business and professional income, almost 46 billion, and 10 billion. The difference in gross private domestic opportunity would be about 204 billion dollars for the seven-year period, and 47.5 billion for 1970 alone.***

The programmatic significance of the estimates

These estimates also indicate the magnitude and nature of the efforts

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* About 8-9 percent a year for about two years from first quarter 1964; about 5 percent a year or somewhat higher thereafter.

**The estimated difference in employment is greater than the estimated difference in unemployment because the high growth rate would draw more people into the labor force than the low growth rate would.

***The use of such precise figures in the estimates related to economic performance throughout this chapter results from the integrated and balanced *American Economic Performance Budget* already referred to. The statistical reconciliation of all figures leads to the precise figures. As actual forecasts and/or goals, the precise figures are merely indicative of broad bands.

we must make, to turn our full potentials into actuality. For example, the same chart on page 77 indicates by how much consumer spending and personal incomes need to be raised; the high importance of wage adjustments geared to productivity gains instead of lagging far behind them; and the great importance of an entirely new farm program, to overcome the vast disparity of farm income and the almost unique concentration of poverty among farm people. The indicated difference of more than 81 billion dollars in transfer payments for the seven-year period as a whole, and more than 16 billion in 1970 alone, identifies the urgency of about doubling by 1970 the average annual benefits to our senior citizens, and of taking many other large steps to expand human welfare programs.

In order to cope with unemployment due to automation and technology, to respond to the intimate connection between poverty and the many millions of people who still live in substandard housing, and to rebuilt our deteriorating urban areas, private and public investment in residential nonfarm construction needs to be about 79 billion dollars higher for the seven-year period as a whole, and 16.5 billion higher in 1970 alone, than is likely to result if policies connected with the low economic growth rate persist.* And finally, the chart indicates the role of public spending.

The scope of these programmatic needs makes it obvious that much more is required besides calling a halt to the policy of tight money and rising interest rates. But doing this in itself would accomplish much. To take only a few illustrations, how can the top priority needs for a great and sustained housing effort and a decent level of income for farmers be met, so long as the prevalent monetary policy is making housing more and more costly, and burdening farmers with higher and higher interest costs on their rapidly mounting debts? How can we commit ourselves to enough increases in transfer payments for the benefit of the aged and others dependent upon an enlarged national sense of welfare responsibility, so long as we embrace the principle and practice of huge transfer payments to those who need them least, in the form of rising interest rates? How can we make war against poverty by forcing the lower half of the income structure to pay higher and higher interest rates to the upper half? Moreover, calling a halt to the prevalent monetary policy would afford concrete evidence of our realism and determination on all fronts. For this policy in itself is the outstanding nationwide example of the degree of our economic and social default.

The next four charts conclude the quantifications in this study.

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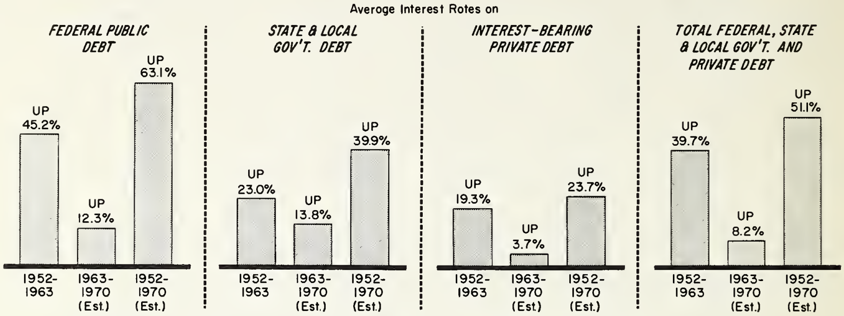
* For full treatment of the importance of the Herculean efforts needed with respect to housing, see *Two Top-Priority Programs to Reduce Unemployment.*

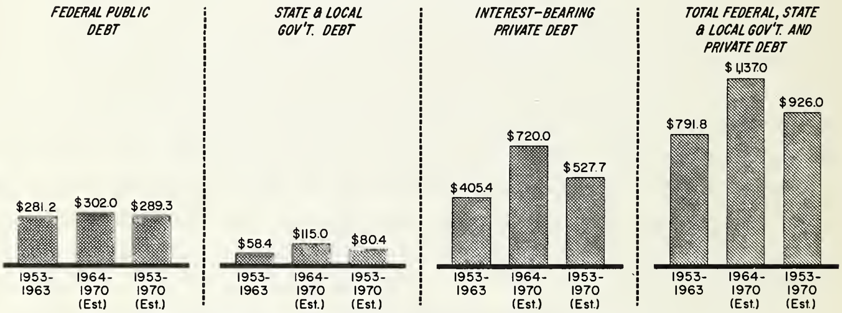
INTEREST RATE TRENDS, 1952-1963 AND ESTIMATES FOR 1963-1970 IF RECENT POLICIES ARE CONTINUED*

Average Interest Rates on



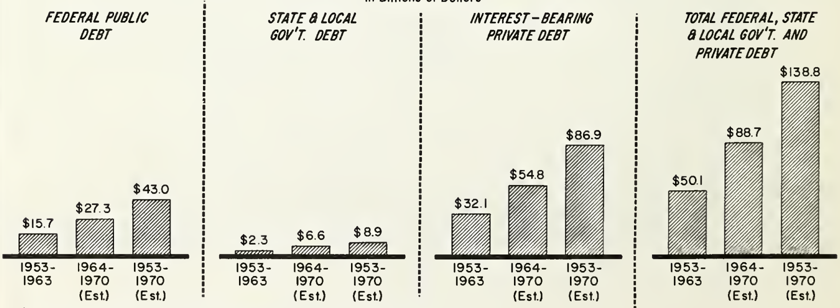
TRENDS IN SIZE OF DEBT, 1953-1963 AND ESTIMATES FOR 1964-1970 IF RECENT POLICIES ARE CONTINUED*

Average Annual Debt in Billions of Dollars



INTEREST CHARGES IN EXCESS OF CHARGES COMPUTED AT 1952 INTEREST RATES, 1953-'63 & PROJECTED 1964-1970*

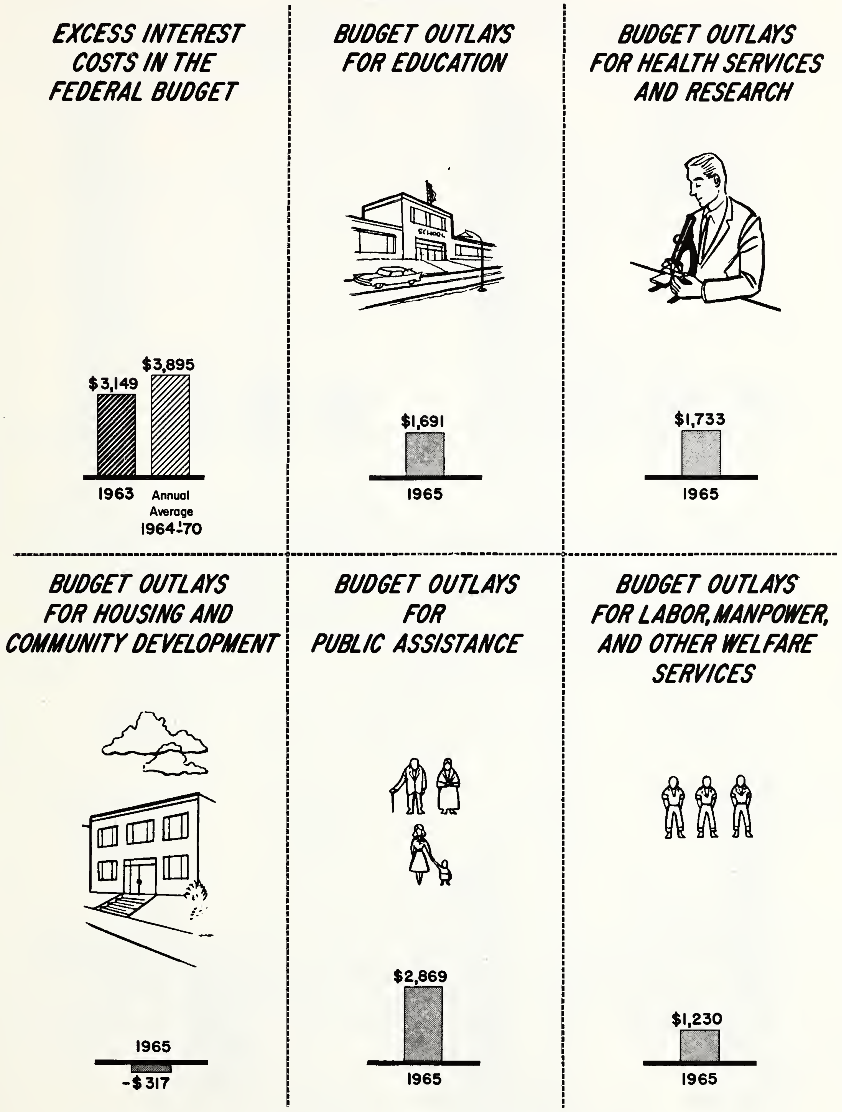
In Billions of Dollars



*Assuming continuation of recent monetary and general economic policies
Data: U.S. Treasury and Office of Business Economics, Department of Commerce

ESTIMATED EXCESS INTEREST COSTS IN THE FEDERAL BUDGET 1964-1970 CONTRASTED WITH OTHER COSTS RELEVANT TO THE WAR AGAINST POVERTY*

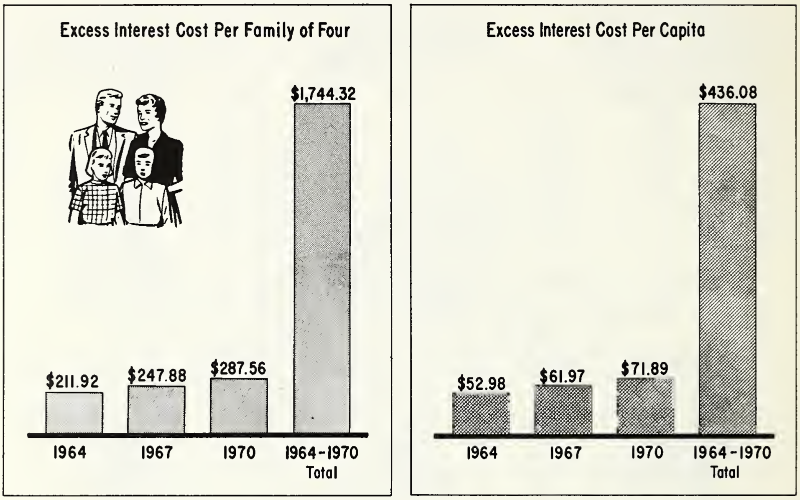
Millions of Dollars



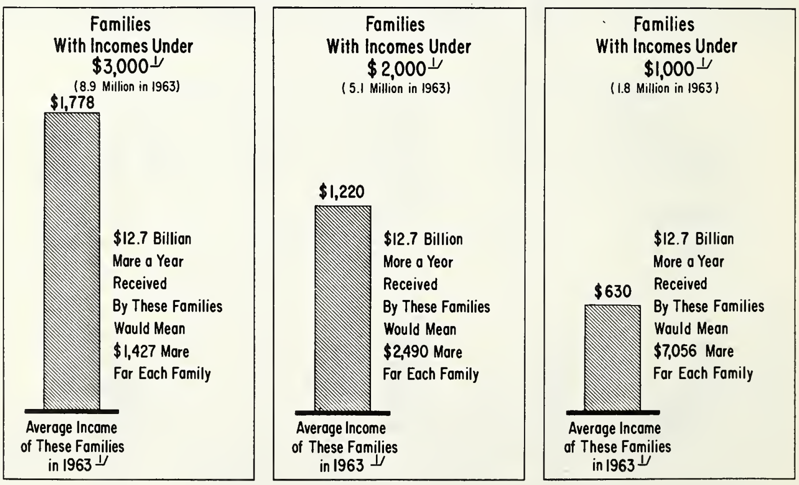
*Interest cost, calendar years; Budget outlays, fiscal year 1965, as proposed in the President's Budget.

HOW 88.7 BILLION DOLLARS IN EXCESS INTEREST COSTS, 1964-1970 WOULD BURDEN THE AMERICAN PEOPLE

Calendar Years



HOW $12.7 BILLION A YEAR, 1964-1970 -THE ANNUAL EXCESS INTEREST COST- COULD BE USED TO RELIEVE POVERTY



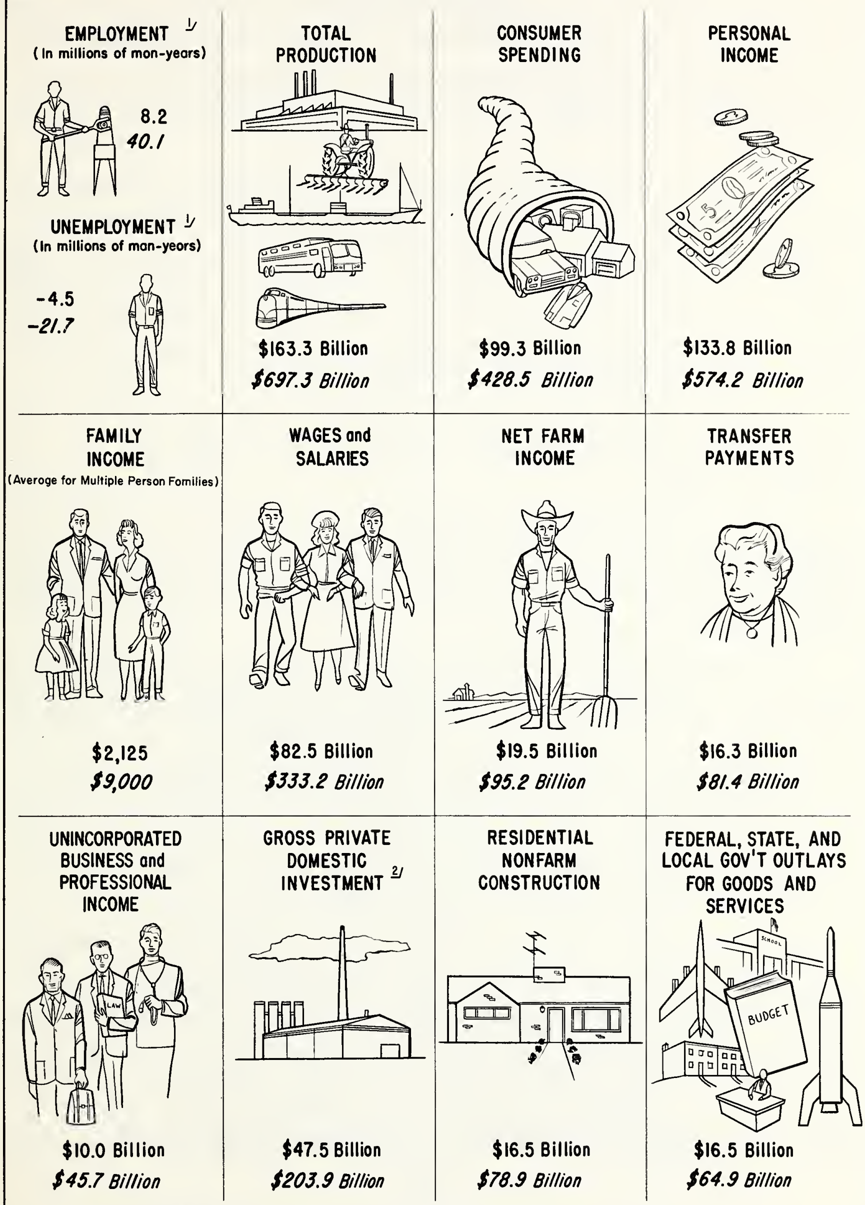
Note: Family and Income Data from Bureau of the Census.

1/ Income distribution analysis is stated in 1962 dollars because the original determination of the income needed to lift families above the poverty level was made in terms of 1962 dollars.

DIFFERENCES IN RESULTS OF HIGH AND LOW ECONOMIC GROWTH RATES, 1964 - 1970

Bold face - Difference In 1970; *Italics - Difference for seven year period as a whole*

(Dollar figures in 1963 dollars)



1/ High growth rate would draw more persons into the labor market than low growth rate.

2/ Including net exports of goods and services.

XI. How To Call A Halt To The Prevalent Monetary Policy

For reasons already stated, the policy of tight money and rising interest rates does not need to be altered in minor respects; it needs to be terminated. This termination cannot be left to the money managers alone. The time has come to propel them to do—in the interest of the economy, the nation, and the people—what they still have no intention of doing on their own.

The Federal Reserve System and Board are composed of honest and well-meaning men. But they have an unshakable vested interest, intellectual and psychological, in the prevalent monetary policy. Despite the rising volume of temperate and well-reasoned criticism of this policy, and vindication of this criticism by actual economic and financial trends, the Federal Reserve has maintained a position of "independence" which has passed from warranted steadfastness to unwarranted obstinacy.

The degree of "independence" of the Federal Reserve in earlier times

The word "independence" always has a pleasant ring, until one recognizes with Mr. Justice Holmes that a word is but the skin of a living thought, and varies in color and content according to the time and circumstance in which it is used.

About eighty years ago, the belief arose that Federal legislation dealing with certain nationwide problems had become too specialized for initial administration by the Executive Branch or initial interpretation by the Judiciary. This led to establishment of various "independent" regulatory agencies, such as the Interstate Commerce Commission. Somewhat the same thinking entered into creation of the Federal Reserve System and Board about a half century ago, following experience which revealed dangerous weaknesses in our banking system or lack of system.

From the outset, however, the limitations imposed upon the "independence" of the money managers were considerable, especially by those Presidents deemed effective in the verdict of history. And in times of great domestic or international crisis or both (such as the era of the Great Depression and World War II), no great "national dialogue" was needed to obtain almost universal acceptance of the principle and practice that the policies of the Federal Reserve System and Board should be in support of,

rather than in conflict with, other basic economic and financial policies legislated by the Congress, executed by the President, and affirmed by the people.

Recent Federal Reserve "independence": the "nonpolitical" argument in its behalf

A drastic revolt against the principles and practices described above occurred at the very time when it had never been more imperative that they be maintained or even strengthened. This revolt—unsubdued to date—gained momentum around 1951, the year of the famous "accord" between the Federal Reserve and the Treasury. That was not a year of peace and quiet. It was a year when we were engaged in a struggle usually called a "limited" war, but which in fact evidenced a critical worldwide situation which still endures.

The revolt of the money managers, therefore, did not spring from reason nor experience. Instead, the revolt lifted the refrain that monetary policy during World War II and reconversion and during the early stages of the Korean war, when used to reinforce other national policies and objectives, had been an "engine of inflation." Completely ignored were these considerations: The financing of World War II had been a uniquely successful undertaking in the annals of this or any country. The inflation during World War II had been remarkably restrained, all things considered. The inflations during reconversion and during the early stages of the Korean war were due to a vast range of factors, including opposition to anti-inflationary measures by many of the powerful exponents of the new "independence" of the Federal Reserve.*

The popularization of this revolt took the form of an attack upon the Administration then in power, in which political and other interests locked hands. Some within the Administration, or appointed by it, joined in the attack openly or secretly. Curiously, this essentially poltical revolt benefited by the slogan that the Federal Reserve System and Board should be made more "independent" of "political" influence.

This slogan, still made use of, is one of the puniest and most disingenuous on record. It holds that the "independence" of the Federal Reserve from "political" interference should shield it from any scintilla

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* For fuller treatment, see the Conference study, *Tight Money and Rising Interest Rates,* July 1960.

of intervention by those who, under a democracy, exercise the political function of conducting the processes of government. Yet it was not undue "political" intereference during wartime for instrumentalities of government to determine the prices and wages received by every businessman and worker. It is not undue "political" intereference for instrumentalities of government to determine, in peace no less than in war, the amount of taxes paid by all individuals and businesses who pay taxes at all. How, then, can it be deemed undue "political" intereference for comparable instrumentalities of government to concern themselves regarding the management of the people's money, which so vitally affects their fortunes and their livelihoods? Besides, anyone who knows Washington knows that the Governors of the Federal Reserve Board themselves take "political" considerations into account. They are men, not angels.

The degree of "freedom" from Presidential authority

The extraordinary length to which this "independence" of the Federal Reserve System and Board has been carried is written indelibly into the record of the past decade and a half. Presidents Truman and Eisenhower (and this applies also to the economists closest to them) certainly had widely differing views about monetary policies. Yet the same man who served as Chairman of the Federal Reserve Board of Governors during the latter part of the Truman Administration continued to serve throughout the Eisenhower Administration. And although a major portion of the discussion of domestic issues by Senator Kennedy in 1960 was devoted to a sharp attack upon the prevalent monetary policy, the same Chairman continued to serve throughout President Kennedy's Administration (and still serves during the Johnson Administration). Further, there is indisputable evidence that, at some times during the Administrations of Presidents Eisenhower and Kennedy, and even more so toward the end of President Truman's term of office, the policies of the Federal Reserve were strongly felt by some of the most important economic advisors * of these three Presidents—and by at least two of the three Presidents themselves—to be in serious conflict with the economic policies of the Administration. This is unsound, no matter which of the conflicting policies happens to be "right."

Nor is it a satisfactory answer to this problem to point out that there have been established some inter-agency committees, which enable the Chairman of the Federal Reserve Board and those occupying the main economic and fiscal posts under the Administration in power to get together

* Not always limited to the President's Council of Economic Advisers.

(at times with the President there) to talk and to attempt reconciliation of conflicting views and policies.* For there needs to be some point where definitive decisions can be made, even when reconciliation is not feasible. And the very existence of this ultimate power would greatly encourage voluntary reconciliation in meaningful rather than obfuscated terms. The operations of the Congress and the Supreme Court permit many varieties of views, and do not require any individual to abandon his views at any time; but these operations nonetheless provide for ultimate decisions which may override as well as reconcile. Indeed, the Federal Reserve System and Board now are in significant ways far more "independent" than the Supreme Court or the Congress, because the supposedly technical and abstruse aspects of monetary policy render it less subject to the watchful eye of an informed people.

It may be said that the refusal of the three Presidents discussed—with the exception of President Truman to a degree—to make known to the Congress or to the public their disagreement with the prevalent monetary policy casts some doubt upon the importance of the conflict between them and the Federal Reserve. Any such conclusion is unjustified. Passive acquiescence by the Chief Executive demonstrates mainly that the "independence" of the Federal Reserve System and Board has proceeded dangerously close to the point of no return: Presidents have preferred to suffer policies with which they have disagreed, rather than to run the real or fancied "political" risks of challenging the august monetary authorities. To the extent that this condition prevails, it imposes upon the country much worse "political" liabilities than to have the monetary authorities kept reasonably in line with other basic national economic policies, through proper instrumentalities available for this purpose.

The degree of "freedom" from Congressional control

Least meritorious of all is the argument that ultimate political responsiveness of the Federal Reserve System and Board—using the term "political" in the valued rather than in the deprecatory sense—is reasonably assured by the responsibility of the monetary authorities to the Congress alone. The very nature of modern government is such—and the Federal Reserve Board of *Governors* [italics added] is government no matter what the Governors may say—that major national economic and financial policies cannot efficiently and wisely be initiated, altered, nor receive legislative sanctions where needed, without the balanced participation of the Congress

* These inter-agency relationships existed in fact, long before their much-publicized formalization was made the occasion for excessive claims of change and improvement.

and the President. In addition, some needed shifts from time to time in monetary policies—which the money managers in fact undertake without going to the Congress—occur under circumstances which would not permit effective Congressional review and action, but which could and should involve effective Presidential participation. Stated more broadly, our traditional and evolving distribution of responsibility between the Congress and the Executive Branch applies to the Federal Reserve System and Board no less cogently than elsewhere.

The money managers themselves have shown the thinness of their plea that responsibility to the Congress alone is enough. A few years ago, when there was substantial sentiment in the Congress itself to modify the Federal Reserve structure and policies by legislation, the cry was raised in testimony before the Congress that this, too, would "interfere" with the sacrosanct "independence." Top officials of the Federal Reserve joined in this cry.

The current "independence" ignores the forward trend in economic thought and policy

We have noted that the money managers are more "independent" today than they were in earlier times. Yet the trends of thought and action in the United States and elsewhere—responsive to the economic facts of life—have moved even further toward recognition that policies developed by independent "expert" bodies must be integrated with an overall policy developed in a broader perspective. We should always recall that Woodrow Wilson, under whose brilliant leadership the Federal Reserve System and Board were created, once said that the expert always sees what is under the microscope under his eye, but never sees what is under his nose.

The momentous Employment Act of 1946—still far from fulfilment of its true potentials—embodied an overwhelming bipartisan affirmation by the Congress that there is need for a comprehensive and integrated national economic policy. Tax policy, spending policy, and monetary policy, as well as many other national policies, reinforce or combat one another. To determine any one of them in isolation is as anachronistic as if a mammoth corporation kept scrupulously apart the determination of its price policies, its investment policies, and its financial policies.

The Federal Reserve spokesmen themselves have admitted the illogic of their position. For they have combined assertions of "indepedence" with exaggerated claims that monetary policy is a more powerful weapon for preventing inflation or promoting economic growth than almost any other

policy. How can our national economic policies be fully responsible, if the one alleged to be the most powerful is allowed to proceed "independently?"

The high relevance of current international conditions

The economic and financial leaders of those free nations overseas which have made the best records of economic growth and low unemployment in recent years—records far surpassing and poignantly challenging our own—regard it as unthinkable that a "central bank" function should be separated from the mainstream of economic policy so completely as is the case in the United States. And these leaders have become even more correct, now that our domestic and international economic and financial problems have become so enduringly intertwined.

The increasing responsible support for this viewpoint was indicated very well in a July 14, 1964 editorial in the *Washington Post*. It said:

> "Congress in its concern with immediate issues never anticipated the economic objectives and criteria that should guide Federal Reserve policies. Conscious of this glaring deficiency, the majority members of the House Banking Subcommittee have formed a series of proposals designed to achieve a closer coordination between monetary policies and the *other* [italics added] economic policies of the Federal Government. . . .
>
> The United States is the only great power in which monetary policy is not subject to the firm control of the incumbent administration . . . and an institution that produces something less than optimal results in the absence of great pressures and is the spawning ground for a dangerous conflict in time of trouble cannot be tolerated in a world where monetary policies really matter. The time for a thoroughgoing reform has arrived."

How true this is, for we are not in untroubled times now.

Toward effective control by the Congress: Congressional guidelines for monetary expansion

In the very nature of monetary policy, appropriate control by the Congress cannot possibly be achieved by the type of Congressional reviews now undertaken, nor by Congressional sway over the purse strings of the money managers in their administrative operations, nor by the power of the Senate to confirm or reject Presidential nominations to the Federal Reserve Board. To be sure, the Congress always has plenary power to enact more specific and effective guides to monetary policy, but this should now be made manifest by new legislation. The time has come for the sword, still hanging in the air, to descend upon the aberrant.

The most important proposal offered by this study is that the Congress enact legislation requiring that the rate of expansion of the non-Federally held money supply, as determined by the operations of the Federal Reserve System, should on an annual basis be kept in a reasonable relationship with the goal for economic growth set forth in the annual *Economic Report of the President,* in line with the maximum employment, production, and purchasing power objectives of the Employment Act of 1946. This would in general take care of the trends in interest rates, which are largely responsive to the rate of expansion or contraction of the money supply. As there may be room for considerable disagreement among those best qualified to judge, as to whether a given rate of economic growth may best be facilitated by an approximately equivalent expansion of the money supply, it may well be desirable that the Congress permit the Federal Reserve to regulate the expansion of the money supply within a reasonable discretionary range. But this range should be stated quantitatively by the legislation; otherwise the discretionary grant would change nothing. It is unacceptable that the money managers be permitted to engineer, with such intolerable economic results, the wide gaps which have existed in recent years between the growth in the money supply and the needed rates of economic growth set forth in the President's *Economic Reports.*

Can the Congress "know enough" to do this? The decision would be no more difficult than when the Congress decides how much money the Government shall spend and for what, or how much taxation shall be imposed and upon whom. The Congress, for a long time now, has directly been prescribing many important rates of interest. The Congress even has the power to declare war.

Would the proposal delegate undue legislative powers to the President, in that it would require the Federal Reserve to conform its regulatory policies, in the respect indicated, to the economic growth targets set forth in the President's *Economic Reports?* Not so; tariff legislation involves comparable delegation to the President. Further, the Congress, with the aid of the Congressional Joint Economic Committee, is expected under the Employment Act of 1946 to evaluate the *Economic Reports* and implement only such portions of them as it sees fit. If the Congress disagreed with the President's economic growth target in any year, it could use its own target when imposing quantitative guidelines upon the Federal Reserve System and Board.

Altering the Federal Open Market Committee

A second step proposed by this study, also requiring legislation, re-

lates to the Federal Open Market Committee. This body regulates the reserves of the commercial banks through its purchases of Treasury securities, which in turn affect trends in the money supply, and correspondingly affect trends in interest rates. The Open Market Committee is now composed of twelve members, including the seven Governors of the Federal Reserve Board (appointed by the President and confirmed by the Senate) and five representatives of the regional Federal Reserve banks. Because the latter are representatives of essentially private banking interests, this confers upon them undue power in determining fundamental national monetary policies. In fact, it gives to these five men a veto power, at least whenever they may be able to get one or two of the seven members of the Board of Governors to go along with them.

It is entirely wholesome that public institutions, such as the Federal Reserve Board of Governors, should have formal or informal devices for consulting with and receiving advice from the private interests which they regulate. But there is all the difference in the world between the privilege of giving advice and the exercise of ultimate public power. At the very least, since the exercise of the monetary power affects some other great economic interests as much or more than it affects banking interests, the members of the Open Market Committee who are not members of the Federal Reserve Board of Governors (and the Governors also) should be more truly representative of these wider economic interests. Far better still, Congressional legislation should confer upon the Federal Reserve Board of Governors itself the exclusive authority to make those basic decisions affecting the money supply which are now made by the Open Market Committee—subject, of course, to the reduced "independence" of the Federal Reserve Board already discussed. There is no more reason why the Federal Reserve Board should share its most basic monetary decisions with a group of bankers than why the Secretary of the Treasury or the President—or the Congress—should share basic national economic policy decisions with a group of bankers, farmers, college professors, or labor leaders. The makers of basic national economic policies should be public servants, responsible to the elected representatives of the people.

Enlarging the President's authority in the area of monetary policy

Complementary to the two proposals just discussed, the third proposal offered by this study is that the Congress by legislation require that each *Economic Report of the President* include a full enunciation of monetary problems and needed policies, thoroughly integrated with the other basic

economic problems and needed policies in these same *Reports*. What sense does it make, that the Congress should look *primarily* to the Federal Reserve Board to recommend changes in legislation affecting basic national monetary policies, but that the President should always have the power to veto such legislation? Where the President has the power to say "no," he should also have an equivalent power of initial recommendation. Of course, in one sense, he has this power now, even with respect to monetary matters. But the Congress, in the manner proposed, could transmute this power from a usually theoretical one to a constantly practical one, by making clear its own intent that the President was literally expected to give monetary policy the place it deserves in his *Economic Reports*. The President should be relieved by the Congress itself of any situation, at any time, which might breed the impression in any quarter that his role as an initiator of basic monetary policies is competitive with, or even secondary to, that of the Federal Reserve Board.

Strengthening the President's hand through his appointing powers

A fourth proposal offered by this study, also toward more effective Presidential action in the area of monetary policy, relates to appointments to the Federal Reserve Board of Governors. Of course, the President now makes these appointments, subject to Senate confirmation. But the fourteen-year terms now in effect are far too long for those exercising the kinds of powers entrusted to these Governors. In addition, terms of this length shield them too much from initial choice, and reappointment choice or rejection, by any particular President. These terms should be shortened by legislation to four years, and, while the terms should remain staggered, the term of the Chairman should be made coextensive with that of the President. Beyond this, it would seem desirable that legislation remove any possible legal doubt as to the power of the President to shift the Chairmanship from one member of the Board to another, so that this action could be taken even when any particular Chairman was in mid-term. This series of changes would help the President to exert appropriate pressures upon the Federal Reserve System, through a method entirely consonant with our public traditions, and without having to run the gauntlet of the "political" difficulties which may now be engendered if and when he attempts to do so.

Toward more selective monetary controls

The foregoing proposals, if adopted, would create a more favorable institutional framework and procedure for the greatly needed reconstruction

of national monetary policy. They would restore popular control of the nation's money supply. They are far more important than the large number of limited, detailed, and technical proposals frequently discussed; hence the dominant stress upon them in this study.

But there is one additional substantive element in monetary policy which merits discussion here. The Federal Reserve System and Board are dedicated mainly to those monetary controls which expand or contract the total money supply. Quite apart from their errors even within the scope of this aggregative approach, the whole theory that the entire economy in all its parts needs more or less credit and higher or lower interest rates now or at any other point in time is painfully lacking in discernment. It represents gross failure to take account of the *relationships* in the economy, the simultaneous need for more of some things and less of others, and the whole problem of economic balance. This same neglect has marred many of our other national economic policies.

Toward the economic and social good, we all recognize that some people need tax reductions and/or certain types of public assistance more than others, and that some people need income supplementation more than others. Entirely similarly, some people and some lines of corporate or other joint ventures need credit more than others, and need it on different terms. And it is only infrequently that almost all lines of economic endeavor need credit stimulation or restraint; generally, some lines need stimulation and others need restraint at the same time. Wise national economic policies deal with priorities, and for this the blunderbuss method will not suffice.

To illustrate specifically, this study has already cited times during the eleven-year period under review when investment in producers' facilities should have been restrained vigorously, even while the rate of private consumption and productive public outlays should have been given every encouragement. Even now, the rate of investment in producer's facilities is *relatively* much too high to be sustainable, and the rate of investment in housing and urban renewal is much too low to cope with the unemployment problem or to meet our national needs. Yet tight money and rising interest rates, as now imposed by the Federal Reserve, compete with productive public outlays, and restrain both private and public investment in housing for the inadequately served mass market in the lower half of the income structure. Meanwhile, tight money and rising interest rates do not restrain investment in producers' facilities, because such investment is not heavily dependent upon borrowing or rates of interest; indeed, higher interest rates may occasionally facilitate such investment by lifting the rate of saving.

The answer of the Federal Reserve to all this is that the task of selectivity (so far as credit and interest rates are concerned) should be predominantly in the hands of private credit institutions, or that the "free market" should ration credit, while the central banking authority should determine only the aggregates. The fatal flaw in this position is that this process does not ration credit according to real individual, business, or national needs. There is no close connection, under such a policy, between the ability to obtain credit and the need for it. Such a policy, instead, tends to feed the fat and starve the lean. It restrains and hurts farmers and small businessmen who are sinking, frustrates essential objectives of State and local public borrowers, and places no restraints upon speculators or industrial investors even when they are flying high as kites. As an anti-inflationary weapon, it pours oil on the flames and water on the ashes.

Such a national monetary policy is akin to what would happen if the Government handed over to the financial community, or to some other group, billions of dollars worth of tax reductions in the aggregate, or billions of dollars of public spending in the aggregate, and then instructed this group to distribute the bounties where it thought they would do the most good. Or, it is akin to what would happen if, in a period of high inflationary pressures, the Government declared that taxes should be increased by so many billions of dollars in the aggregate, and then delegated elsewhere the function of determining who got the reductions and in what amounts.

These analogies are not precise, because we all recognize that private credit institutions are essential and useful, and that detailed money management cannot be concentrated in public hands or in a "central bank," to anywhere near the same degree that taxation or public spending are concentrated in public hands. But the Federal Reserve Board goes too far when it rejects these analogies *in toto*. In so doing it fails to recognize adequately that *it is a public instrumentality*—and this perhaps gets to the heart of the matter.

The fifth proposal made in this study, therefore, is that the Federal Reserve System and Board combine recourse to the aggregative approach with a much more selective and discriminating type of credit control. There is already much experience relevant to this, and more can be gained by doing. Insofar as this change in emphasis requires legislation, this study recommends that the Congress provide it. And the Executive Branch, by all means now available, and by any others later made available, should encourage it.

Toward more effective control by an informed American public

One of the most encouraging developments in our national life is that the American people, and their leaders in various voluntary economic and other organizations, are taking an ever-increasing interest in our national economic policies. They should not be scared off by the bugaboo that monetary policy is beyond their comprehension. Every effort should be made, beginning with efforts by the President and the Congress, to develop a more informed public opinion on this subject. This educational effort, which should be distinguished from the actual making of public decisions, could bring powerful pressures to bear upon the money managers even prior to adoption—in whole or in part—of the legislative proposals set forth above. This educational effort should be shared by business, labor, and farm leadership, by public officials at State and local levels, by public interest organizations, and last but not least by the academic community of economists.

Unless this effort gets started promptly and proceeds vigorously, the great damage already done to all of our personal, business, and nationwide interests by the prevalent monetary policy will grow to irretrievable damage.

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